

**THE CONTRIBUTION OF JUSTICE MM CORBETT
TO THE DEVELOPMENT OF THE LAW OF TAXATION
IN SOUTH AFRICA**

by

WESSEL JOHANNES VAN DER WALT

Submitted in fulfilment of the requirements for
the degree of

MASTER OF ACCOUNTING SCIENCES

at the

UNIVERSITY OF SOUTH AFRICA

SUPERVISOR: PROFESSOR G K GOLDSWAIN

September 2007

CONTENTS

Page

Summary of Conclusions	i - iv
Declaration	v
1. The context, delineation, method and structure of the investigation	
1.1 Tax legislation requires constant interpretation, revision and refinement	1
1.2 Delineation of the area of research	3
1.3 The purpose of this research project	3
1.4 Research method	5
1.5 The importance of this research	6
1.6 The structure of this research report	7
2. An overview of Justice Corbett's life	
2.1 Family history	10
2.2 Schooling and the Second World War	11
2.3 Studies at the Universities of Cape Town and Cambridge	14
2.4 Justice Corbett's period at the Bar	15
2.5 Justice Corbett's period on the Bench	17
2.6 Tributes to Justice Corbett	23
2.7 Conclusion	27
3. Jurisprudence in South African Tax Law	
3.1 Introduction	29
3.2 Theories on Jurisprudence	30
3.2.1 Law-enforcement Theory	31
3.2.2 The Rule of Law as Procedural Justice	32
3.2.3 Dicey's Approach: The Protection of Basic Rights	33
3.2.4 The Rule of Law as justice in the Substantive sense	33
3.2.5 Conclusion	34
4. Tax Avoidance	
4.1 Introduction	36
4.2 Substance over form principle in tax law	37
4.2.1 Application of Substance over Form in the U.K.	37
4.2.2 Conclusion of Substance over Form Principle	41
4.3 General anti avoidance rule – avoidance of estate duty - SIR v Gallagher	42
4.3.1 Application of the principles derived from the Gallagher case	46
4.4 Section 103(1) applied to loans to shareholders From a company - CIR v Louw	50

4.4.1	Application of the “test of normality” in the Louw case	52
4.4.2	Conclusion regarding Louw	55
5.	Gross income	
5.1	Introduction	62
5.1.1	Receipts in a realisation company or trust are capital in nature - JM Malone Trust v SIR	64
5.1.2	A company is not independent from its shareholders when the nature of a transaction has to be determined - Elandsheuwel Farming (Edms) Bpk v SIR	67
5.1.2.1	Application of the Elandsheuwel case	70
5.1.2.2	Lifting of the corporate veil as applied in the United Kingdom	76
5.1.2.3	Lifting of the corporate veil as applied in New Zealand	77
5.1.2.4	Conclusion on Elandsheuwel	80
5.1.3	Intention on the sale of land - SIR v Rile Investments (Pty) Ltd	86
5.1.3.1	Application of the principles of Rile Investments	87
5.1.3.2	Conclusion on Rile Investments	88
5.2	Apportionment between capital and revenue income Tuck v CIR	89
5.2.1	Application of the apportionment principle in Tuck	91
5.2.2	Conclusion on the principle of apportionment in Tuck	94
5.3	Source of Income Essential Sterolin Products (Pty) Ltd v CIR	95
5.3.1.	Application of Essential Sterolin Products principle	98
5.3.2	Conclusion on Source of Income	100
5.4	Conclusion	100
6.	General Deductions	
6.1	Introduction	102
6.2	Apportionment of expenses	103
6.2.1	Background	103
6.2.2	Apportionment in the case of dividend stripping - CIR v Nemojim (Pty) Ltd	107
6.2.3	Application of the apportionment principle developed in Nemojim	108
6.2.4	Application of the general deduction formula as applied in Nemojim	109

6.3	The lack of a profit motive	
	- De Beers Holdings (Pty) Ltd v CIR	112
6.3.1	References to the “profit motive” as discussed in the De Beers Holdings judgement	114
6.3.2	Application of the definition of stock in De Beers Holdings	119
6.3.3	Conclusion on De Beers Holdings	121
6.4	The close connection between expenses incurred and relevant income earning activities	
	- CIR v Standard Bank of SA Ltd	122
6.4.1	Application of the Standard Bank case	124
6.5	When is apportionment appropriate	
	- CIR v Pick ‘n Pay Wholesalers (Pty) Ltd	126
6.5.1	Conclusions	
6.5.1.1	Conclusion on apportionment	130
6.5.1.2	Conclusion on the deductibility of losses	131
6.6	Incurral of costs	133
6.6.1	Expense determined after year end - Edgars Stores Ltd v CIR	133
6.6.2	Application of the Edgars Stores’ principle on incurral	135
6.6.3	Expense determined after year end - CIR v Golden Dumps (Pty) Ltd	137
6.6.4	Conclusion on incurrals	139
6.7	Conclusion	141
7.	Special deductions – Capital allowances	
7.1	Introduction	144
7.2	Definition of Process of Manufacture	
	- SIR v Safranmark (Pty) Ltd	145
7.2.1	Application of the Safranmark definition of a “Process of Manufacture”	147
7.2.2	Conclusion on Safranmark	151
7.3	Definition of “Plant”	
	- Blue Circle Cement Ltd v CIR	152
7.3.1	Application of the definition of “plant” as espoused in Blue Circle	156
7.3.2	The definition of “plant” in the United Kingdom	158
7.3.3	The definition of “plant” in Australia	161
7.3.4	Conclusion on “plant” and “a process of manufacture”	163
7.4	Deductibility of Foreign Exchange Losses	
	CIR v Felix Schuh SA (Pty) Ltd	165

7.4.1.	Conclusion on the treatment of foreign exchange losses	166
7.5	Conclusion	167
8.	Hierarchy of Double Tax agreements in relation to the Act.	
8.1	Introduction	169
8.2	The DTA are part of the Income Tax Act - SIR v Downing	170
8.2.1	Application of the Downing case	172
8.3	Conclusion	173
9.	The Principle of Legitimate Expectation	
9.1	Introduction	175
9.2	The principle of legitimate expectation	176
9.3	The principle of legitimate expectation in English Law	177
9.4	Application of the principle of legitimate expectation in South African tax law	179
9.5	The Promotion of Administrative Justice Act	184
9.6	Conclusion	186
9.7	The New Constitution	186
9.7.1	The Bill of Rights and its influence on taxpayers' rights	188
9.7.2	Section 74 (3) as it then was prior to amendment of the Income Tax Act	189
9.8	Conclusion on the new Constitution	191
10.	Conclusion on Justice Corbett's contribution to the South African Tax Law	
10.1	Introduction	193
10.2	Brief evaluation of Justice Corbett's contribution to South African law	194
10.3	Knowledge and experience to interpret law	195
10.4	Independence of the Court	200
10.5	Substance over form	203
10.6	International jurisprudence	205
10.7	The Constitution	207
10.8	Final words on Justice Corbett's contribution to the development of law of taxation in South Africa	209
11.	Bibliography	211
12	Appendix A : Tax Cases in which Justice Corbett was involved	214
13	Appendix B : Judgements of Justice Corbett cited	218

Declaration by Candidate

I declare that the dissertation entitled “The Contribution of Justice MM Corbett to the Development of the Law of Taxation in South Africa” is my own work and that all the sources that I have used or quoted have been indicated and acknowledged by means of complete references.

.....
W J van der Walt
Student no: 0654 922 5

.....
Date

Declaration by Supervisor

I hereby grant permission for Wessel Johannes van der Walt to submit his dissertation entitled "The Contribution of Justice Mm Corbett to the Development of the Law of Taxation in South Africa" for examination purposes.

.....
Supervisor: Professor GK Goldswain
Department Applied Accountancy
University of South Africa

.....
Date

SUMMARY OF CONCLUSIONS

1. Background

Justice MM Corbett was appointed as a judge in 1963 and was appointed a judge of appeal in 1974. He became Chief Justice of South Africa in November 1988 and he retired in September 1993. During this thirty year career on the bench he has made a substantial contribution to the development of the law in South Africa. This was especially so in the field of the law of taxation.

2. Interpretation of the Act:

Justice Corbett was well known for his formative style which suited the tax cases over which he presided. A typical example of a case in which the interpretation of a section of the Act is required, would be to establish whether a particular taxpayer could be classified as a “manufacturer” in order to qualify for certain tax incentives that are applicable to manufacturers. Such an interpretation was required in *Safranmark*¹, in which Justice Corbett, in his dissenting minority judgement, gave an excellent interpretation of the meaning of the word “manufacturing”. His interpretation, it is submitted, gives an accurate definition of the normal meaning of the word “manufacture”. He was of the opinion that it was up to the legislature to amend the section to include a wider meaning to the section. They later did so.

¹SIR v Safranmark (Pty) Ltd, 43 SATC 235

Where sections are vague, outdated or incomplete, the judgements that are delivered may cause amendments to be made to the Act. A major change to a leading section of the Act was the amendment of section 23(g) to exclude the wording “wholly and exclusively”. This amendment occurred shortly after the judgement was delivered in the *Solaglass* case², which concerned the strict application of section 23(g). The court in that case did not apply apportionment of expenses incurred partly for trade and partly non-trade purposes. When the changes to section 23(g) were instigated, the legislature relied heavily on the judgements of Justice Corbett in *Nemojim*³, *Pick n Pay*⁴ and *De Beers*⁵, which, together with *Rand Selections*⁶, are the major apportionment cases in South African tax law.

3. Substance over form

Justice Corbett’s formative approach was evident in *Elandsheuwel*. The section 103 cases of *Gallagher*, *Louw* and *Burgess* confirmed his formative approach to the legislation and the facts of the case. The fact that he applied a formative approach does not imply that he always overlooked the substance of the matter. When applying section 103 to tax avoidance, he used a formative approach. In other avoidance cases, such as *Nemojim* and *De Beers*, he did not use the formative approach, but used the

² *Solaglass Finance Company (Pty) Ltd v CIR*, 1991 (2) SA 257 (A), [53 SATC 1](#).

³ *CIR v Nemojim (Pty) Ltd*, 45 SATC 241

⁴ *CIR v Pick ‘n Pay Wholesalers (Pty) Ltd*, 49 SATC 132

⁵ *De Beers Holdings (Pty) Ltd v CIR*, 47 SATC 229

⁶ *CIR v Rand Selections Corporation Ltd*, [20 SATC 390](#)

substance approach. The substance over form approach may favour the Commissioner.

4. International jurisprudence

It is clear that Justice Corbett consulted overseas case law before he delivered judgements. In most of his judgements he refers to such cases, especially to the reports from the United Kingdom. This is very noticeable in the *Pick 'n Pay* case.

Having been a scholar at Cambridge, he was exposed to a wider legal background. It did give him some insight and also personal contact with others in the legal field of the Commonwealth.

The introduction of the principle of legitimate expectation by Justice Corbett was an important milestone in the development of the South African law. It highlights his understanding of the law and its international development and his foresight in respect of the application and implementation of legal principles. The principle of legitimate expectation specifically targets the relationship between the government and the citizen. This principle has been applied in several court cases, which illustrates the value of Justice Corbett's foresight in introducing it into South African law. This principle is embodied in our new Constitution.

5. The Constitution

Justice Corbett's greatest legacy is probably that he was one of the main proponents of a Bill of Human Rights and its incorporation in the Constitution of South Africa. Chapter 2 of the Constitution of the Republic of South Africa, Act 108 of 1996, contains a Bill of Rights. The rights contained in the chapter are of general application insofar as the state and citizens are concerned. Many of the rights do, however, apply to tax administration and to how the South African Revenue Service conducts itself in dealing with the South African taxpayer.

The Constitution and particularly the Bill of Rights had a major impact on legislation in South Africa. Several cases were heard in the Constitutional court regarding sections of the Income Tax Act that were in contravention of the Constitution. Many amendments were made to the Income Tax Act to meet the terms of the Constitution.

ABSTRACT

Mr Justice Corbett made a substantial contribution to the South African tax law as he delivered several judgements during his long career on the bench. Starting from the lower ranks as a judge he became Chief Justice of South Africa. Precedents set by his judgements are considered important and indicative of the level of South African tax law.

This dissertation observes his background, looks at the operations of the tax court in South Africa and examines whether his judgements were cited and applied in subsequent cases as accepted precedent. International case law is referred to, to compare his judgements with comparable international tax law.

Key Terms

MM Corbett

Substance and form

Normality

Corporate veil

Apportionment

Profit motive

Process of manufacture

Legitimate expectation

CHAPTER 1 **THE CONTEXT, DELINEATION, METHOD AND**
STRUCTURE OF THE INVESTIGATION

1.1 **TAX LEGISLATION REQUIRES CONSTANT INTERPRETATION,**
REVISION AND REFINEMENT

When it comes to taxes, everyone has a contribution. It was Albert Einstein, the celebrated physicist of the twentieth century, who observed the complexity of the laws of taxation and said¹:

“The hardest thing in the world to understand is the income tax.”

Quick to add to this observation was a remark from an unknown comedian:

“For every tax problem there is a solution which is straightforward, uncomplicated and wrong.”

Predictably many opinions have been aired on the issue of tax avoidance and evasion:

“The avoidance of tax may be lawful, but it is not yet a virtue.”

- Lord Denning, a renowned English judge.

“If you don't drink, smoke, or drive a car, you're a tax evader.”

- Thomas S. Foley, an American politician.

¹ All quotes from *The Quotation Page*, an internet website: www.quotationspage.com

“The avoidance of taxes is the only intellectual pursuit that still carries any reward.” - John Maynard Keynes, economist.

“The trick is to stop thinking of it as 'your' money.” – a Revenue auditor who wants to remain anonymous.

Benjamin Franklin, a previous president of the United States said:

“In this world nothing is certain but death and taxes - but at least death doesn't get worse every year”

The quotes above take a rather light-hearted view of taxes. They illustrate the many views and different interpretations people have about taxes.

Disputes arise as a result of the fact that taxpayers and the South African Revenue Services (“SARS”) have different interpretations regarding the application of the Income Tax Act². Judgements of the High Court create precedents for these matters which are usually adhered to in subsequent court cases depending on the status of the court delivering the judgement. Such judgements are also used by SARS and by taxpayers as a reference when they apply the Act to a specific circumstance. The Act is normally amended annually, though it is not unusual for more than one set of amendments to be promulgated during a year.

² The Income Tax Act no. 58 of 1962, as amended. It will be referred to as “the Act”.

1.2 DELINEATION OF THE AREA OF RESEARCH

This dissertation will research the contribution made by the former Chief Justice of South Africa, Justice M M Corbett, an extremely influential figure, to the advancement of clarity in tax law. He is an individual who has received wide acclaim in legal circles for his contribution to the interpretation and development of the law in South Africa generally, but in particular, the tax law.

In this dissertation, the decisions of the court are analysed in respect of those cases in which Justice Corbett delivered a judgement, irrespective of whether his judgement was the majority or the minority judgement. Naturally, in those cases in which he delivered the majority judgement, the judgement created a precedent, unless it was subsequently overturned by legislation or it was found to be distinguishable on the facts and therefore was not followed. Some of his minority judgements have, however, served as persuasive authority in subsequent cases.

1.3 THE PURPOSE OF THIS RESEARCH PROJECT

An analysis of the judgements delivered by Justice Corbett identifies and clarifies some important principles that apply in the tax system. Although some tax principles are peculiar to South Africa, Justice Corbett based his judgements on international trends and standards. He was a member of the panel of judges that considered most of the major tax cases that were brought before the Appellate Division between 1968 and 1992.

In referring to the judicial interpretation of codes and practices³, in *The Nature of the Judicial Process*, United States Supreme Court Justice Cardozo observed the following:

“There are gaps to be filled. There are doubts and ambiguities to be cleared. There are hardships and wrongs to be mitigated if not avoided. Interpretation is often spoken of as if it were nothing but the search and the discovery of a meaning which, however obscure and latent, had none the less a real and ascertainable pre-existence in the legislator’s mind. The process is, indeed, that at times, but it is often something more. The ascertainment of intention may be the least of a judge’s troubles in ascribing meaning to a statute. The fact is, says Gray in his lectures on the Nature and Sources of the Law, that the difficulties of so-called interpretation arise when the legislation has had no meaning at all; when the question which is raised on the statute never occurred to it; when what the judges have to do is not to determine what the legislature did mean on a point which was present to its mind, but to guess what it would have intended on a point not present to its mind if the point had been present.”

According to Justice Cardozo, the judge, being the interpreter for the community of its sense of law and order, should supply omissions, correct uncertainties and harmonise results with justice by means of a method of free discretion. He quotes Eugen Ehrlich⁴, a German legal theorist and author in the 1920’s, in stating that *“...in the long run there is no guarantee of justice except the personality of the judge”*.

³ Cardozo, Benjamin N. *The Nature of the Judicial Process*, Yale University Press, USA, first published in 1921, p. 12.

⁴ Ehrlich, Eugen. *Das Zwingende und Nichtzwingende Recht im Bürgerlichen Gesetzbuch für das Deutsche Reich*, Jena, first published in 1899, p26.

The position taken by Justice Cardozo is that research into the principles underlying certain judgements contributes to a greater clarity on the same and similar issues to be decided on in the future. This is also the case in tax matters. The purpose of this dissertation is to analyse Justice Corbett's contribution to the development of the law of taxation in South Africa.

1.4 **RESEARCH METHOD**

A literature review of the judgements that were delivered by Justice Corbett in relation to tax issues during the period he sat on the bench, is the research method used. Reports on South African Tax Cases were searched on LexisNexis Butterworths Complete Tax Library on CD Rom⁵ for all the tax cases in which Justice Corbett⁶ was involved. All the tax cases where Justice Corbett delivered a judgement are discussed in this dissertation. Other principles of law, such as the doctrine of legitimate expectation⁷ espoused by Justice Corbett and noted as a principle applied in tax matters, are discussed as and where appropriate during the course of this dissertation. The South African judgments that were delivered by Justice Corbett are also compared to similar tax cases and foreign decisions from Australia, Britain, New Zealand and Zimbabwe to see whether his judgements were in line with international trends and principles.

⁵ Butterworths' Complete Tax Library on South African Tax Law, South African Tax Cases and Silke on South African Income Tax. Update: December 2006

⁶ See Appendix A.

⁷ See Chapter 9.

The foreign cases that have been selected for comparison were heard in countries that have legal and tax structures that are similar to that of South Africa. In fact, many principles of the present Income Tax Act are based on the principles of the Australian Income Tax Act of 1901⁸. Even newer legislation such as section 24F of the South African Act, which deals with film investments, has wording that differs very little from the wording of the equivalent Australian tax legislation.⁹

In those instances in which the judgements of Justice Corbett were not applied in subsequent, similar cases, the possible reasons for its non-application are discussed.

Tax reference books and articles were also consulted relating to his work on the bench.

1.5 THE IMPORTANCE OF THIS RESEARCH:

Justice Corbett gave many far reaching decisions on tax matters on which there was previously no certainty during the time that he was on the Bench.

The principles derived from these decisions form part of the prevailing tax law

⁸ The 1917 Income Tax Act of South Africa was based on the Income Tax Act from the newly formed federation of Australian colonies. The Australian federation was formed on 1 January 1901. Its Income Tax Act was passed in that year. By 1917 some necessary amendments were made and this piece of legislation was used as a base for the draft of the South African Income Tax Act.

⁹ Australian films: Section 375 of the Australian Income Tax Assessment Act of 1997.

and are a valuable addition to tax legislation. It will be seen from an analysis of his judgements during the course of this dissertation, that most of the principles espoused in his judgements have been accepted and applied in subsequent cases. A judgement in the High Court creates a precedent or principle; it is adhered to thereafter, unless it is rejected in subsequent judgements or is overturned by legislation. These principles provide the context within which the meaning of relevant concepts, words and phrases in tax law can be interpreted.

When the tax authorities, the taxpayers and their tax advisors understand how the judiciary analyse and apply tax principles, concepts, words and phrases, they are in a better position to predict the outcome, should the matter be taken on appeal to a court

Case law has provided a range of important principles, which have become part and parcel of the South African tax law. A thorough understanding of the principles enunciated by the courts is a pre-requisite for understanding the Act itself. The judgements delivered by Justice Corbett are excellent illustrations of how the judiciary, through the court system, elucidate the principles. The court system includes the Constitutional Court, the various provincial divisions of the High Court, the High Court of Appeal and the Special Court for the Hearing of Appeals on Income Tax matters.

1.6 THE STRUCTURE OF THIS RESEARCH REPORT

A historical perspective should form an important part of any attempt to analyse the circumstances of the judgements delivered by Justice Corbett. He

was appointed as a judge in 1963 and his career ended in 1993. His personal history and the time frame within which he operated are discussed in chapter 2. Due to the changes that occurred over the years, some of his judgements have been superceded by new legislation although, remarkably, most of his judgements have stood the test of time. They are still valid and are used as a reference point.

In chapter 3, the confines within which he operated regarding the prevailing theories on jurisprudence are discussed. For example, there was no Bill of Rights in operation during the course of his professional career. Legislation had to be enforced regardless of whether it infringed on what is now regarded as a fundamental right of a taxpayer. Attention is given to the possible effect that the prevailing political and judicial circumstances could have had on his judgements.

Justice Corbett delivered judgements (both majority and minority judgements) in eighteen tax cases in the Appellate Division of which eight judgements went in favour of the Commissioner and ten in the favour of the taxpayers. The Commissioner was the appellant in ten of the eighteen cases. Therefore, the majority of the cases were heard on appeal by the Commissioner, yet the majority of the cases were won by the taxpayers concerned. It is impossible, however, to conclude from the statistics that Justice Corbett was either *pro* or *anti fiscus*. Thus his judgements need further analysis and these judgements have been analysed in chapters 4 to 8.

Chief Justice Corbett was instrumental in advocating that the Bill of Rights be incorporated in the New Constitution of South Africa. The impact of the Constitution on the Income Tax Act is briefly discussed in chapter 9.

Chapter 10, the final chapter of this dissertation, presents a summary of and conclusions regarding Justice Corbett's contribution to the South African tax law.

CHAPTER 2 **AN OVERVIEW OF JUSTICE CORBETT'S LIFE**¹⁰

2.1 **FAMILY HISTORY**

Gaining an understanding of the personal history of Justice Corbett can produce an insight into his outlook on life and therefore the judgements that he delivered.

Michael McGregor Corbett was born in Pretoria on 14 September 1923. His father, Alan Frederick, and his mother, Johanna Sibella, called Sybil, (whose maiden name was McGregor) both had connections to the Anglo Boer War, albeit on different sides of that war.

Sybil was born in South Africa. She was a granddaughter of Johannes Brandt, a former president of the Orange Free State Republic, and the daughter of Justice Alexander John McGregor. Justice McGregor practised for some years at the Cape Bar.

Alan Corbett, Michael's father, came to South Africa with the 371st Squadron of Imperial Yeomanry. After the Anglo Boer War, he qualified as a lawyer at Cambridge University. He returned to South Africa to take up a position in the Department of Inland Revenue at its head office in Pretoria. At that time

¹⁰ Condensed from Justice Corbett's biography entitled *The Quest for Justice – Essays in Honour of Michael McGregor Corbett* by E Kahn, Juta & Co, Johannesburg, 1995.

income tax was only levied in the Cape Colony and later in Natal. The remainder of South Africa had no income tax at the time. Prior to 1914, revenue was raised in the country through the imposition of mining taxes and indirect taxes. After taking up a position in the department of Inland Revenue, Alan Corbett was involved in the drafting of the first Income Tax Act of the Union of South Africa, which was promulgated in 1914. He also admitted “responsibility” for drafting the 1922 Death Duties Act¹¹. He ruefully confessed that his drafting of the Act had been criticized, but requested his critics to try their hand at an exercise of this nature. He became the Commissioner for Inland Revenue in 1929. For some years he was the editor of the publication South African Tax Cases¹², a legal publication which reports on the major tax cases during a year.

2.2 SCHOOLING AND THE SECOND WORLD WAR

After Michael Corbett’s father, Alan, became Commissioner for Inland Revenue in 1929, Michael had to commute between Pretoria and Cape Town for the Parliamentary sessions, which usually took place from late January to July each year in Cape Town. Even before his appointment as Commissioner, Alan Corbett’s senior position in the Department of Inland Revenue frequently required him to be in Cape Town during the first half of the year. As a consequence, Michael Corbett attended school in both Pretoria and Cape Town. In Cape Town, he attended the highly regarded Rondebosch Boys High School.

¹¹ *The Quest for Justice*, p 9

¹² Published by Butterworths South Africa, 215 North Ridge Road, Durban..

Initially he was a day scholar who boarded with a family friend, but from standard eight onwards he was a boarder in the school hostel. At school he was a happy and very successful scholar who was also good at sport. He played rugby for all the A teams in his age groups and became a member of the second cricket eleven at a very young age. In June 1938, his father, Alan Corbett, reached the normal retirement age of 60 whereafter he and his wife settled in Cape Town. Michael again became a day scholar. He matriculated in December 1939 at the age of 16. By then, the Second World War had broken out. Michael wanted to enlist, but his parents wanted him to wait until he was 18. He therefore registered at the University of Cape Town for the Bachelor of Arts degree with the intention of proceeding to the LLB degree. Five years of study were required for the two degrees. At that stage, the so-called legal BA course had a large component of law courses. Michael also enrolled for the Latin courses at both first and second year level.

On 14 September 1941, Michael, then in his second year of study at the University of Cape Town, turned 18. At that time the University had a policy which stated that, if a student enlisted in the forces during an academic year, he would be given credit for the courses for which he was registered. Michael decided to register for the third year of study for the BA degree in order to benefit from this generous concession. In April 1942, he enlisted in the South African Tank Corps, knowing that he would be awarded the BA degree. He later attended a course from September 1942 to March 1943 that prepared officers for duty in armoured cars.

Lieutenant-Colonel Moray P Comrie MC, who commanded the First Royal Natal Carbineers, a motorized infantry battalion, was looking for officers

before proceeding north to the war zone. He recruited Michael who remained a proud member of the Carbineers throughout his period of active service and developed a close attachment to Natal. When the First Royal Natal Carbineers arrived in Egypt, all the unit was required to do was to undergo comprehensive training in that country. The training was done in preparation for duty in Italy as part of the Sixth South African Armoured Division which participated in the campaign of the Eighth Army of the Allied Forces.

Lieutenant Michael Corbett was involved in the Italian Campaign from April 1944 to August of that year. He maintained a detailed record of his experiences with the Carbineers in Italy, comprising approximately 207 pages or 90 000 words. On the night of 13 May 1944, Michael nearly lost his life. He had been ordered to lead a strong fighting patrol and, if the enemy failed to reply to artillery fire, to investigate the lie of the land. He recorded the following details of the ensuing events¹³:

“There was no reply by the enemy. I wirelessly back ‘Going forward’. Suddenly, I heard close behind me a deafening explosion – I ducked – glanced back – then forward again, listening intently. Behind me the smoke was clearing away to show a huddled pile of men – three were lying quite still, the other two writhing in agony. Out of the patrol of ten I was the only one to have got off scot-free; four were killed, two were seriously wounded and three got small pieces of shrapnel not serious enough to cause them to be evacuated.”

Rome fell to the Americans on 6 June 1944. At that stage, the Carbineers were *en route* to Florence. During his spell of leave, he went to Rome. With a group

¹³ *The Quest for Justice*, p 13

of colleagues and friends he travelled in a truck to a beach outside Rome. On the way back, another army vehicle collided with the truck. Michael's left arm was broken and the fingers of his left hand torn off. After a long sojourn in hospitals in Italy, Michael was sent back to South Africa in a hospital ship.

2.3 STUDY AT THE UNIVERSITIES OF CAPE TOWN AND CAMBRIDGE

Michael was boarded out of the Army in May 1945. He immediately enrolled for the LLB degree at the University of Cape Town. After completing his studies at UCT, he applied for a scholarship, the Elsie Ballot Scholarship, which was modelled on the Rhodes Scholarship. His application was successful and he was admitted to Trinity Hall, a small Cambridge college, which was famous for its law training and rowing.

Several South Africans were reading for a degree in law at Cambridge at that time. They included Gustav Hoexter, Douglas Shearer, Simon Roberts and Duchesne Grice¹⁴. Michael was permitted to proceed directly with Part Two of the Law Tripos. His law lecturers included Sir Percy Winfield, who taught English Law; C J Hamson, who taught Comparative Law; Glanville Williams, who taught Jurisprudence; and R M W Dias, who taught Roman-Dutch Law. In 1947, Michael obtained a first-class pass in the examination for the law

¹⁴ CG Hoexter was later appointed a Judge of Appeal, Appellate Division of the Supreme Court of South Africa; DLL Shearer also became a Judge of Appeal, Appellate Division of the Supreme Court of South Africa, KwaZulu Natal Provincial Division; Simon Roberts and Duchesne Grice became senior counsel.

degree. Thereafter he read for the LLB degree, for which he also obtained a first-class pass in 1948.

2.4 JUSTICE CORBETT'S PERIOD AT THE BAR

Michael Corbett returned to Cape Town almost immediately and joined the Cape Bar in November 1948. It was notoriously difficult to obtain admission to the Cape Bar. In his first year, the gross earnings from his practice amounted to £132. To supplement the income from his practice, he did what many newcomers to the Bar do: he lectured and marked examination scripts in law subjects. He lectured at the University of Cape Town, of which he has remained a proud *alumnus*, and occasionally at the Technical College.

In 1949, he married Margaret (Peggy) Luscombe. They had three children.

His liberal sentiments attracted him to the War Veterans' Torch Commando. The Torch Command was established in June 1951 and functioned under the presidency of Group Captain A G ('Sailor') Malan. The objectives of the Torch Commando, a political pressure group, were to protect the liberties of the subject, to promote racial harmony and to eliminate all forms of totalitarianism. Michael Corbett was a representative for the Western Cape Region. The Torch Commando criticised the then government's apartheid policies. It should be noted that, in spite of being a member of the Torch Commando, which upheld an anti-apartheid approach, and being regarded as a judge with liberal views, Michael Corbett was appointed to the Bench by the then apartheid government. It is even more surprising that the same

government later endorsed him as the Chief Justice of South Africa when the position fell vacant after the retirement of Rabie CJ.

After three or four years, his legal practice began to prosper. He received many briefs from leading firms of attorneys. These firms included Fairbridge Ardene & Lawton, the same firm in which his great-great-grandfather, Christoffel Brand, had worked for two years in approximately 1812, before he went to the University of Leiden. Michael Corbett's practice was closely associated with that of Graeme Duncan QC with whom he held many junior briefs, largely chamber work.

Michael Corbett is said¹⁵ to have modelled himself on Duncan's austere court manner, diligent attention to detail, short opinions, and his manner of being carefully considered, completely objective and getting straight to the point. In addition, he emulated Duncan's helpfulness to juniors who were struggling in what appeared to them to be a stormy legal sea. In a number of cases, MM Corbett QC appeared with Graeme Duncan as his lead before the Appellate Division.

Michael Corbett concentrated on commercial law in the course of his practice because civil cases proved more interesting to him. Although Michael Corbett did not always win, he was involved with several cases that were regarded as important in their field.¹⁶

¹⁵ *Quest for Justice*, p 23

¹⁶ For example, he appeared in the following cases, which were landmark cases in their fields:

2.5 Justice Corbett's period on the Bench

In 1961, Michael Corbett became one of the last South Africans to be granted the Letters Patent as Queen's Council, before South Africa was declared a Republic in 1961. In 1963, he was appointed as an Acting Judge of the Cape Provincial Division of the Supreme Court. Although he had enjoyed his stint at the Bar, he could simply not refuse a request by the Judge President of the Cape Provincial Division, Andrew Beyers, to join him as a colleague. Michael Corbett regarded it as his duty to accept a position on the Bench, if he were asked to do so, irrespective of the sacrifice, financial or otherwise, that it entailed. In this regard he wrote that¹⁷:

“Whereas it was acceptable that an advocate would turn down an invitation to sit on the Bench on some ideological ground, such as the rejection of the death penalty, almost certainly others rejected an offer

-
- South African Mutual Aid Society v Cape Town Chamber of Commerce, 1962 1 SA 598 (A). The case dealt with delictual damages;
 - Stellenbosch Farmer's Winery Ltd v Distillers Corporation (SA) Ltd & another, 1962 1 SA 458 (A). It dealt with trade-mark infringements; and
 - R Rohloff v Ocean Accident and Guarantee Corporation Ltd, 1960 2 SA 291 (A). It dealt with the right of spouses to sue each other in delict for damages for harm done to person or property.

¹⁷ *The Quest for Justice*, p. 26.

on other grounds, saying: 'I rather like the work of senior practice. It's interesting; you often get briefed by multinational corporations; you travel overseas; you have an exciting life; and what's more a judge's salary you know, really...' ”

From the outset, Mr Justice Corbett proved to be an ideal judge¹⁸. He had the same controlled, quiet manner as Mr Justice Ogilvie Thompson, who held him in high regard. A perfect gentleman, always extremely polite to counsel and witnesses, and never raising his voice in anger, he could still ask the incisive question in a gentle way. As is the case with so many judges, he found that criminal trials tended to become rather boring. Civil cases and appeals proved to be more interesting to him.

A spell as acting judge of appeal followed when two vacancies in the highest court arose. Mr Justice H J Potgieter of the Appellate Division died in 1973 and Chief Justice Ogilvie Thompson retired in 1974. Mr Justice Corbett became a permanent member of the Appellate Division in June 1974.

As the years passed, Mr Justice Corbett climbed the ladder of seniority in the Appellate Division until he became senior Judge of Appeal. On 4 November 1988, the then State President, Mr P W Botha, announced that Mr Justice Rabie, then acting Chief Justice, would retire and that Mr Justice Corbett would become the sixteenth Chief Justice of South Africa. Widespread expressions of appreciation and approval followed the announcement of the new appointment.

¹⁸ *The Quest for Justice*, p. 26.

During his period as a judge, major tax issues were addressed and in many instances he found himself at the forefront of interpreting and shaping the South African tax system.

The distinction between the capital and the revenue nature of income and expenses continued to be hotly debated in the South African courts. Tax-avoidance schemes became more prevalent during the course of his tenure as judge. He also had to deal with issues, such as the *Lategan*¹⁹ principle, that had been left unfinished by his predecessors.

A new Income Tax Act was passed in 1962 and the continuous flow of new legislation from this time required interpretation by the courts. At the same time, many of the court cases that he was involved in were benchmarks or a basis for new tax legislation. Towards the end of his career, Justice Corbett was involved in the drafting of the new post apartheid Constitution for South Africa. It has had a major impact on existing legislation as various sections of some acts have had to be amended to comply with it. Various Draconian sections of the Income Tax Act, such as section 74, regarding search and seizure requirements, have had to be amended to bring them within the ambit

¹⁹ *Lategan v CIR*, 1926, CPD, 2 SATC 16: The principle that emerges from this case is that an amount of gross income “accrues” to a taxpayer in the year of assessment in which he acquires the right to claim payment in the future and not in the year of assessment in which he is eventually paid. In *CIR v People’s Stores (Walvis Bay) (Pty) Ltd* (Justice Corbett served on the panel) the *Lategan* case was held to correctly reflect the law.

of the Constitution and especially the Bill of Rights, which Bill is embodied in the Constitution.

In the ordinary course of events, the Chief Justice would have occupied his position as Chief Justice until he turned 70 in September 1993. However, on 10 February 1993, the then State President, Mr F W de Klerk, announced that the Chief Justice had accepted an invitation to “*play a prominent role in the transitional process*”. According to the press²⁰, the continuation of Chief Justice Corbett in office was welcomed by Mr Mandela, the then leader of the ANC, “*particularly given the wide respect and confidence he enjoys*”. The Democratic Party spokesman on justice, Mr Tony Leon, endorsing the continuance of Chief Justice Corbett in Office, referred to the qualities necessary for a Chief Justice to “*bridge the great divide between the old legal and constitutional order and the new*”.

Chief Justice Corbett played a major role in the drafting of the Interim Constitution²¹ which included the establishment of the Constitutional Court. After a visit to the United States in 1976, he had said that he had become a convert to a Bill of Rights, which has a power of review vested in the courts. In this regard he later commented that “*What I said at the time caused many an eyebrow to lift in governmental and judicial circles*”²².” However, in the

²⁰ *The Quest for Justice*, p, 28.

²¹ Act No. 200 of 1993

²² *The Quest for Justice*, p. 40.

negotiations at CODESA²³ it was accepted that a Bill of Rights should form an integral part of any new South African constitution.

In a speech at the Fourteenth South African Law Conference in September 1993²⁴, Mr Justice Corbett described what he understood to be a person who is suitably qualified for appointment to the Supreme Court:

“... I detect an underlying sentiment that the task of a judge is not a particularly difficult one, and that a person with the required legal qualifications can do the job. In my view, this is an illusion and the sooner it is dispelled the better. The truth is that the task of the judge is one of the most difficult, if not the most difficult there is. And after more than thirty years on the Bench I think I can claim to speak with some authority on the subject. If I were to attempt to sum up in half-a-dozen words the qualities which ideally a judge should have, I would say knowledge, experience, judgement, independence, character and industry.”

“... I am not for a moment suggesting that all judges possess them. On the contrary, it is probably true that few, if any, incumbents of the bench measure up to the ideal. Nevertheless, those are the requirements of the job and the criteria against which candidates for the bench must be measured.”

He went on to say that the ideal judge should have a sound knowledge of the law and the practice of the courts. In our system of very limited specialisation,

²³ The Convention for a Democratic South Africa negotiated a transitional government and interim constitution for South Africa in 1993, leading to an all inclusive democracy in 1994.

²⁴ 1993 De Rebus, issue 959, pp. 962-3.

a judge in a trial division may, in the course of a single term, sit in on criminal sessions, in motion court and in a civil division. In addition, the case before him may involve aspects of private law, administrative law or complex commercial topics such as bills of exchange, insolvency, company law and intellectual property.

On the subject of experience, he said that a trial judge should have a vast well of experience from which to draw. During a single day he could be called upon to give many rulings on procedure, the admissibility of evidence and so forth. In many instances the judge should, from his experience, know almost instinctively what to do. It relates to both fact-finding and the application of the law to the facts. A judge must arrive at the truth, because many more cases are decided on the facts rather than on the law.

Regarding the subject of independence, Justice Corbett said that *“a judge must be beholden to no one.”*

He included temperament and personality in the quality of character. A judge should have the personality to maintain order and dignity in court proceedings. In his opinion, a judge should run the court.

Justice Corbett had the following to say about the quality of industry:

“...And finally industry... Undeniably the bench is no longer a leisurely job. Judges have to read many thousands of pages of record and heads of argument in preparation for each court term. They have to work for long hours, but they have to see to it that they produce with

the minimum delay what the parties have come to court for, that is, a judgement.”

2.6 TRIBUTES TO JUSTICE CORBETT

The following extracts from essays in honour of Justice Corbett are presented as illustrations of the high regard in which his colleagues held him as an individual and of their admiration for his contributions in the legal field:

HH Nestadt²⁵ provides the following description of Judge Corbett’s appearance and attitudes:

“Michael has a trim figure. He is gentle in speech and manner. He plays a useful game of tennis, but is inclined, so to speak, to run round his backhand. Conservative in his dress, he is a true liberal.”

In his essay on Corbett, A S Botha²⁶ gave tribute to Justice Corbett saying that the key to justice is: The power of clear thinking. This power, he believed, is the key to achievement in all human endeavours on an intellectual plane. But not all judges are endowed to the same degree with the ability to think clearly, and so the power manifests itself with varying degrees of efficacy. This accounts for the fact that we have bad judges, good judges, better judges and a

²⁵ *The Quest for Justice*, p.111, *The Chief Justice*, an essay by HH Nestadt, BA LLB (Wits), Judge of Appeal, Appellate Division of the Supreme Court of South Africa.

²⁶ *The Quest for Justice, Essays in Honour of Michael McGregor Corbett*, Juta & Co, Johannesburg, 1995, p.103, an essay on “The Power of Clear Thinking” by A S Botha, BA LLB (Pret.), Judge of Appeal, Appellate Division of the Supreme Court of South Africa.

few great judges. In the latter case the power at work can be observed at its glorious best. On this score he singled out, from amongst the giants of the past, the names of Innes and Schreiner. And from the contemporaries he added a single name: Corbett. He marvelled at the apparent ease with which some of the principles of estoppel were explained in the judgement of *OK Bazaars v Universal Stores Ltd*²⁷. The judgement of *Blyth v van den Heever*²⁸ had been allocated to Michael Corbett. When Botha read the draft judgement, he was stunned. Where uncertainty, confusion and chaos reigned in regard to the ambit of medical negligence, all of a sudden there was now order, clarity and certainty. The mass of material had been beautifully sorted out, arranged, analysed and evaluated; the issues stood resolved as if it had been a “piece of cake” to do so.

C G Hoexter²⁹ states the following about the personal qualities of Justice Corbett:

“It has been given to very few judges of appeal to serve so long. None has done it with greater ability than Michael. Honorary doctorates have been conferred upon him by the Universities of Cape Town, Rhodes, Witwatersrand and the Free State. On the Bench he displays restraint, courtesy to counsel, and the supreme judicial virtue: to listen patiently to argument.”

²⁷ *OK Bazaars v Universal Stores Ltd*, 1973, (2) SA 281 (C).

²⁸ *Blyth v van den Heever*, 1980, (1) SA 191 (A).

²⁹ *The Quest for Justice*, p.107, *A Tribute* by CG Hoexter BA LLB (Cantab) Judge of Appeal, Appellate Division of the Supreme Court of South Africa.

D L L Shearer³⁰ has added the following tribute:

“We were at the same college at Cambridge – Trinity Hall. Already the qualities which have led him to the highest office in the legal profession were plain – great intellectual ability, assiduous pursuit of principle and a quiet tact which puts everyone at ease.”

Lord Steyn³¹ phrases his tribute to Justice Corbett as follows:

“Taking qualities of judicial temperament for granted, it seems to me that the tribute of greatness must be reserved for judges who satisfy five requirements which overlap to some extent. First there is style and theme. Then, critical faculties and powers of legal analysis. Profound knowledge of the law. A great judge must have a coherent philosophy of the role of the courts of law as an arm of government in a broad sense. He must also develop the law in a principled manner. Michael Corbett has in my view displayed all the qualities which I have described.”

T W Bennet³² summarises Justice Corbett’s contribution to the legal system as follows:

³⁰ *The Quest for Justice*, p.113, *Cambridge Days*, an essay by DLL Shearer, BA (Hons) (Natal) LLB (Cantab), Judge of Appeal, Appellate Division of the Supreme Court of South Africa, KwaZulu Natal Provincial Division.

³¹ *The Quest for Justice*, p. 115, *Tribute to a Great Judge*, An essay by Lord Steyn, PC BA LLB (Stell) MA (Oxon), Bencher of Lincoln’s Inn, Lord of Appeal in Ordinary, Great Britain.

³² *The Quest for Justice*, p.123, *Law Applicable to Land in SA*, an essay by TW Bennet, BA LLB (Rhodes) PhD (Cape Town), Professor, Department of Public Law, University of Cape Town

“Among the notable judgements delivered by Chief Justice Corbett are those on the conflict of laws (also called private international law). His rulings in Sperling v Sperling³³ and Ex parte Spinazze & Another NNO³⁴ established new principles in Roman-Dutch private international law, although the careful assessment of the comparative merits of systems from abroad – a hallmark of Mr Justice Corbett’s decisions – gave these cases relevance beyond South Africa’s borders.”

H Corder³⁵ emphasises the contribution made by Justice Corbett to fundamental human rights in the country in the following words:

“Corbett CJ’s judgement in Administrator, Transvaal v Traub laid the foundations for a flowering jurisprudence around the principle of audi alterem partem. He rejected the previously influential ‘classification’ approach which held that the rules of natural justice only apply to judicial and quasi-judicial decisions and not to those that were ‘purely administrative’. It was artificial reasoning.”

H C Nicholas³⁶ concentrates on Judge Corbett’s contribution in the field of patents and trusts by stating the following:

³³ 1975, (3) SA 707 (A).

³⁴ 1985, (3) SA 650 (A).

³⁵ *The Quest for Justice*, p. 132, *A bill of rights in a changing SA*, an essay by H Corder, B Comm LLB (Cape Town), Professor, Department of Public Law, University of Cape Town.

³⁶ *The Quest for Justice*, p. 264, *Opening the Door*, an essay by HC Nicholas, BA LLB (Wits), Judge of the Supreme Court of South Africa.

“As a judge of appeal, Michael Corbett was a member of the court in the great case of Gentiruco AG v Firestone SA (Pty) Ltd³⁷, which was a landmark case in South African patent law and a storehouse of learning on the validity and infringements of patents. He became a specialist on trusts and wrote several articles and books on this subject.”

2.7 CONCLUSION

A person is influenced by many factors which affect his personal and professional life. Justice Corbett is no exception. His father was a lawyer as well as being the Commissioner of Inland Revenue for many years. Michael Corbett grew up in this environment and the law later became his career.

A major influence on his political persuasion was the fact that he had had first-hand experience of World War II and became part of the post-War liberal humanitarian movement. He understood and supported the philosophies on human rights. Later in his life he was instrumental in the incorporation of the Bill of Rights in the South African Constitution.

He had a high regard for the law and the Bench. He studied at the Universities of Cape Town and Cambridge, which are renowned for the high standards of their law departments. In his practice he concentrated on commercial cases as opposed to criminal work. Justice Corbett clearly had a greater interest in the commercial and economic facets of the law, such as trusts and patent law, whilst the criminal facet appeared to “bore” him. This preference explains his

³⁷ Gentiruco AG v Firestone SA (Pty) Ltd, 1972, (1) SA 589 (A).

keen understanding of tax issues, which are part of the commercial component of the law.

3.1 INTRODUCTION

Like any judge, Justice Corbett's judgements were influenced by his background and personal convictions³⁸. Additionally the legal system prevailing in the country concerned has a substantial influence on the judgements handed down. This chapter summarises the international theories on law, including taxation, and the interaction between government and its citizens that prevailed during the latter half of the 20th century. It presents the judicial background to the judgements delivered by Justice Corbett.

Justice Corbett's background indicates that he had liberal and humanist convictions. As already previously mentioned, he was a member of the "Torch Commando". These humanist convictions were in step with the international trend among jurists who believed that it was their task to deliver substantive justice. Their credo was that in order to be just, the judge must be independent. The question which can be asked is whether Justice Corbett was independent. This question can only be answered by referring to internationally accepted legal theories on independence.

The brief summary that follows indicates how jurists the world over theorised about the independence of the judiciary during the period that Justice Corbett was in office.

³⁸ See chapter 2

A judge's function is to interpret the law, not to make it³⁹. The promulgation of legislation is a process which is entirely at the discretion of Parliament, and, in the case of post apartheid South Africa is subject to the limitation of the Constitution, which ensures the independence of the courts.

Justice Corbett had an excellent ability to interpret tax legislation. However, loopholes in tax legislation are targeted by taxpayers who enter into, or develop elaborate schemes to avoid taxation. For many years the courts in South Africa, England and New Zealand have had to grapple with the issue of how to apply existing tax legislation to various tax-avoidance schemes, including how the principle of substance over form influences the evaluation of a tax avoidance scheme. Justice Corbett's approach to tax avoidance will be compared to the approach taken by the judiciary, both locally and internationally.

3.2 THEORIES ON JURISPRUDENCE

In order to be able to evaluate a judgement meaningfully, it is necessary to present a brief analysis of some of the basic philosophies of the judicial system of the time. According to Bix⁴⁰, all jurisprudence theories can be

³⁹ United States Supreme Court Justice Cardozo, N in *The Nature of the Judicial Process* (1921)

⁴⁰ Bix, B *Jurisprudence: Theory and Context*, second edition, Westview Press, London, 1999.

categorised into four groups. The four groups are⁴¹: law-enforcement; the rule of law as procedural justice; the protection of the basic rights of the citizen through pre-announced rules that are administered by the ordinary courts; and the rule of law as justice in the substantive sense. Each of these groups of theories is discussed in turn in the sections that follow.

3.2.1 Law enforcement

According to the law-enforcement theory, the government rules in accordance with the law when its actions towards the citizens of that country are legally authorised by Parliament. This theory concerns a rule by law and not a rule under law. A citizen who feels aggrieved by a prejudicial government action may appeal against such action. The government concerned must then prove that the citizen was dealt with in terms of a valid legal rule. Once the government has proved that its action was correct in terms of legislation, it has discharged its responsibility. For example, apartheid legislation such as the Group Areas Act, was legally authorised by Parliament and could deny its citizens the right to own property. In the context of taxation, the search and seizure provisions gave the Commissioner the right to enter a taxpayer's premises without the authorisation or supervision by the court.

⁴¹ *The rule of law – a reassessment*. An essay by A S Matthews BA LLB PhD (Natal), Professor and Head of Department of Private Law of the University of Natal. The essay is included in *Fiat Iustitia, Essays in memory of Oliver Deneys Schreiner* by Ellison Kahn, Juta & Co, Johannesburg, (1983).

The shortcoming of this theory is that it says nothing about the content or the form of laws. It could result in the denial of the citizens' most fundamental human rights.⁴²

3.2.2 The rule of law as procedural justice

The crux of the rule of law theory, is the regulating of a society in accordance with the law. In his article, *The rule of law and its virtue*, Joseph Raz⁴³ states the main principles as follows:

- i) Laws should be prospective, open and clear.
- ii) Laws should be relatively stable and not change too often.
- iii) Open, stable and general rules should govern subordinate legislation.
- iv) There should be an independent judiciary charged with the application of the law to cases brought before it.
- v) The principles of natural justice should be observed.
- vi) The courts should have the power of review in order to ensure the implementation of the above principles.
- vii) The courts should be easily accessible to the subjects of the state.
- viii) The discretion of crime-preventing agencies should not be allowed to pervert the law.

⁴² *The rule of law – a reassessment*, an essay written by A S Matthews. The essay is included in *Fiat Iustitia, Essays in memory of Oliver Deneys Schreiner* by Ellison Kahn, p. 127.

⁴³ *The rule of law and its virtue*, (1977) 93 LQR, p. 195.

Clearly this theory, together with Dicey's approach, which was developed in England, forms the basis of our new Constitution.

3.2.3 Dicey's approach: the protection of the basic rights of the citizen through pre-announced rules that are administered by the ordinary courts

Dicey's approach is concerned with justice in the material sense. It stands for the legal protection of civil liberties and is famous for its principles, namely:

- i) No one shall be subject to penalties except for a distinct breach of law that is established before the ordinary courts.
- ii) The principle of equality before the courts.
- iii) The subject is more effectively protected when rights and remedies are incorporated into the ordinary law of the land.
- iv) Observance of legality in the form of clear pre-announced rules administered by independent courts.⁴⁴

Dicey's approach became prevalent in the latter half of the 20th century in common law countries, including South Africa.

3.2.4 The rule of law as justice in the substantive sense.

The International Commission of Jurists has become the chief exponent of the most expansive theory of the rule of law by making the theory the epitome of the achievement of justice in its fullest sense. The Commission made the following grand statement in this regard at its conference in Lagos in 1961:

⁴⁴ *The rule of law – a reassessment*, p. 128.

“The rule of Law is a dynamic concept which should be employed to safeguard and advance the will of the people and the political rights of the individual and to establish social, economic, educational and cultural conditions under which the individual may achieve his dignity and realize his legitimate aspirations in all countries, whether dependent or independent.”

The “law enforcement” theory and the theory of “the rule of law as justice in the substantive sense” are extremist theories and probably not achievable in practice.⁴⁵ This very liberal theory has been partially incorporated in the New Constitution as far as it was practical, mainly in the Bill of Rights.

3.2.5 Conclusion

Justice Corbett’s stance against apartheid indicates his opposition to the law enforcement theory. His belief in human rights probably typifies him as a follower of the rule of law as justice in the substantive sense. This position explains his formative approach to tax law which is clearly seen from the judgements he gave in tax cases⁴⁶. Professor D M Davis⁴⁷ remarks that Justice Corbett had *“adopted a literal and formative approach to tax legislation,*

⁴⁵ *The rule of law – a reassessment*, p. 128.

⁴⁶ Examples of Justice Corbett’s formative approach are: *CIR v Louw*, 45 SAT C113 (discussed in chapter 4) , *Elandsheuwel Farming (Edms) Bpk v SIR*, 39 SATC 163 (chapter 5) and *De Beers Holdings (Pty) Ltd v CIR*, 47 SATC 229 (chapter 6).

⁴⁷ An essay by D M Davis on *“Substance over form in tax law: The contribution of Mr Justice Corbett” - The quest for justice*, p. 151.

thereby curbing the powers of Revenue and providing greater certainty as to the rights of taxpayers.”

His approach rather reflects the approach by Dicey described in paragraph 3.2.3, which was adhered to by astute jurists of that time.

CHAPTER 4 **TAX AVOIDANCE**

4.1 **INTRODUCTION**

In the early seventies, several incidences of alleged tax avoidance were taken to the South African courts to determine the extent and ambit of section 103, the general anti-avoidance section of the Act. The first of these cases in that decade was *SIR v Geustyn, Forsyth and Joubert*⁴⁸; Corbett J was a member of the panel of judges in that case.

As already mentioned, the English courts adopted the judicial anti-avoidance principle of substance over form⁴⁹ during the 1980's. This was a major change from the courts' approach, which, up to that point, had been formative. This led the South African judiciary, in the late 90's, to develop the substance over form principle in line with that of the United Kingdom and other countries⁵⁰.

Initially, the substance over form principle amplified the general anti-avoidance section 103. Subsequent amendments to section 103 have incorporated some substance over form elements. These amendments were

⁴⁸ 1971 AD, 33 SATC 113.

⁴⁹ See chapter 3.

⁵⁰ *IRC v Duke of Westminster*, 1936, AC 1 (HL), *WT Ramsay Ltd v IRC*, 1982, AC300 (HL) All ER 865 and *Furniss v Dawson*, 1984, AC 474 (HL) 1 All ER 530.

prompted by the various judgements given and incorporates provisions to prevent some of the avoidance schemes attempted by taxpayers.

Justice Corbett presided over two court cases in which the Commissioner appealed on the grounds that the taxpayer had entered into a scheme that fell within the ambit of section 103(1). These cases are described in the paragraphs 4.3 and 4.4.

4.2 SUBSTANCE OVER FORM PRINCIPLE IN TAX LAW

4.2.1 The application of substance over form principle in the United Kingdom

In his article on Justice Corbett, Professor Davis (*supra*) writes that for many years the House of Lords adopted a literal approach to the interpretation of tax law. The concept that the taxpayer is entitled to arrange his affairs in so as to minimise his tax liability was enshrined in English jurisprudence in the case of *IRC v Duke of Westminster*⁵¹. This was the case until the 1980's when the courts subtly changed their approach and developed a comprehensive judicial anti-avoidance doctrine.

It is generally accepted that the first step in this development was taken by the House of Lords in *WT Ramsay Ltd v IRC*⁵². This case dealt with a scheme to create tax losses which could be offset against profits in unrelated transactions. The taxpayer created a company, the investment in which was represented by

⁵¹ *IRC v Duke of Westminster*, 1936, AC 1 (HL).

⁵² *WT Ramsay Ltd v IRC*, 1982, AC300 (HL) All ER 865.

two debt instruments. One debt paid no interest whilst the other paid a substantial rate of interest, above market rates. The interest rates were fixed so that the interest that the debts produced could offset the gains and losses on disposal. When the taxpayer later disposed of the low interest debt, he claimed a tax loss. Had the House of Lords followed the *Westminster* doctrine, the taxpayer might well have won his case. However, Lord Wilberforce held that the statute should not to be interpreted literally, but should be interpreted in the light of the context and purpose of the legislation. The court rejected the argument that only Parliament should be entitled to prevent tax avoidance by means of legislation which plugs a hole that had hitherto been exploited by the taxpayer. Lord Wilberforce said that:

“While the techniques of tax avoidance progress and are technically improved, the courts are not obliged to stand still. Such immobility must result either in a loss of tax, to the prejudice of other taxpayers, or to Parliamentary congestion or to both. To force the courts to adopt, in relation to closely integrated situations, a step by step, dissecting, approach which the parties themselves may have negated would be a denial rather than an affirmation of the true judicial process... The capital gains tax was created to operate in the real world, not that of make-believe.”

Shortly after delivering its decision in *Ramsay* (supra), the House of Lords was confronted with another complex scheme⁵³. This scheme was intended to convert a non-deductible bad-debt loss on a claim by a parent company against a subsidiary into a deductible loss on stock. In disallowing this loss, Lord Diplock stated the following:

⁵³ IRC v *Burmah Oil Co Ltd*, (1981), 54 TC 200 (HL).

“It would be disingenuous to suggest, and dangerous on the part of those who advise on elaborate tax avoidance schemes, to assume that Ramsay’s case did not mark a significant change in the approach adopted by this House in its judicial role to a preordained series of transactions into which there are inserted steps that have no commercial purpose apart from the avoidance of liability for tax.”

The House of Lords further extended this anti-tax-avoidance approach in *Furniss v Dawson*⁵⁴. This case concerned a company that wanted to transfer stock into a controlled company, located in the Isle of Man, which was sold to an independent purchaser. The transfer of the stock to the Isle of Man company was exempt from capital gains tax under a provision which permitted a controlling corporation to transfer stock to its subsidiary. The Isle of Man company was not subject to English tax. Consequently, the taxpayer hoped to avoid tax on the sale, at least until the disposal of the shares in the Isle of Man company. In finding for the Revenue, the House of Lords confirmed that the principle in such cases was that tax should be imposed in accordance with the end result and should take into account the step by step approach, especially when a step is inserted that has no commercial purpose apart from the avoidance of a tax liability. In the step by step approach, the courts normally look at the validity of each separate step.

Professor Davis notes that these developments place enormous power in the hands of Revenue. Lord Brightman conceded as much when he stated that the approach in *Furniss v Dawson* converted the problem of defining prohibited forms of tax avoidance into a question of fact that is to be determined by the

⁵⁴ *Furniss v Dawson*, 1984, AC 474 (HL) 1 All ER 530.

Commissioner. The Commissioner initially decides whether the steps taken by the taxpayer were premeditated and whether they had a commercial purpose. This trilogy of cases marked a major departure from the *Westminster* approach, namely to arrange one's affairs to minimise tax.

Professor Davis observes that the uncontrolled nature of the power which appeared to be concentrated in Revenue caused the House of Lords to review this approach in *Craven v White*⁵⁵. Significantly, this case also concerned a transaction which used an Isle of Man company to avoid tax on the proceeds of the sale of shares. In *Craven's* case, however, the transfer of the shares to the Isle of Man company occurred at a time when both the ultimate sale of the stock and the terms of the sale were uncertain. In a split decision, the majority of the House of Lords sided with the taxpayer on the grounds that the sale of the Isle of Man company was not a preordained transaction within the context of the test set out in *Furniss v Dawson*. Delivering the main judgement, Lord Oliver confirmed that the court should adopt a narrow approach to the development of a judicial anti-avoidance doctrine. Lord Oliver's conservative approach to the liberal *Furniss v Dawson* test is reflected in the following passage:

“... judges are not legislators and if the result of a judicial decision is to contradict the express statutory consequences which have been declared by Parliament to attach to a particular transaction which has been found as a fact to have taken place, that can be justified only because, as a matter of construction of the statute, the court has

⁵⁵ *Craven v White*, 1989, AC 398 (HL) 3 All ER 495.

ascertained that which has taken place is not, within the meaning of the statute, the transaction to which those consequences attach.”

Professor Davis is of the opinion that, in general, English courts are required to adopt a more aggressive approach to tax avoidance than South African courts. This different approach is the result of the absence of a general anti-tax-avoidance provision in the United Kingdom income tax legislation that is comparable with the provision that appears in section 103(1) of the South African Income Tax Act. Nevertheless, the House of Lords has subsequently followed a more cautious approach to the interpretation of tax legislation as illustrated in *Craven v White* and particularly in *Ensign Tanker Leasing Ltd v Stokes*⁵⁶ and *IRC v Fitzwilliam*⁵⁷.

4.2.2 Conclusion on the substance over form principle

The South African courts have recently begun to follow the English and international trend in applying the principle of substance over form⁵⁸. Professor Davis points out, as already mentioned above, that the principle of substance over form has the danger of placing uncontrolled power in the hands of Inland Revenue. He suggests that a narrow approach to this anti-avoidance doctrine is necessary.

⁵⁶ 1992, 1 AC 665 (HL).

⁵⁷ 1993, 1 WLR 1189 (HL).

⁵⁸ See *Relier (Pty) Ltd v CIR*, 60 SATC 1, and *Erf 3183/1 Ladysmith (Pty) Ltd and Another v CIR*, 58 SATC 229

The ensuing chapters will show that Justice Corbett was more inclined to focus on the form of a transaction (the literal or formative approach). This approach curbed the powers of the Department of Internal Revenue and provides greater certainty regarding the rights of taxpayers.

In the following paragraphs, an analysis is undertaken to determine the extent to which the English and New Zealand judiciary approach the substance over form principle and the impact their approach has had on the judgements delivered by Justice Corbett in similar cases. It is to be expected that some cases will contain conflicting perspectives. Naturally, Justice Corbett cannot be considered to be the sole architect of the judgements that he delivered. Credit is also due to the representatives and opposing counsel who presented well-founded arguments, as well as to the input delivered by the other judges on the panel.

4.3 GENERAL ANTI-AVOIDANCE RULE: AVOIDANCE OF ESTATE DUTY

In the case of *Secretary for Inland Revenue v Gallagher*⁵⁹, Justice Corbett was required to determine whether section 103(1) was applicable in the circumstances. In 1968, the taxpayer entered into a scheme for the ultimate benefit of his children. At that time the taxpayer held shares in public companies that were quoted on the Johannesburg Stock Exchange.

⁵⁹ 1978 (2) SA 463(A), 40 SATC 39

The taxpayer then formed another company named Stanley Patrick Holdings (Pty) Ltd ('SPH') and at the same time created trusts for the benefit of his three children and donated his shares in SPH to the trusts. In terms of the trust deeds, all of which contained identical provisions, the trustees were directed to distribute the income received to the child concerned.

As a consequence of these donations, the trustees of the three trusts became the holders of the entire share capital of SPH. Thereafter the taxpayer entered into a written agreement with SPH in terms of which he sold to the company his assets, namely, the shares in the public companies. The purchase price remained a debt that SPH owed to the taxpayer and was payable on demand.

In determining the taxpayer's liability for normal tax for the 1969, 1970 and 1971 tax years, the Commissioner applied the provisions of section 103(1) of the Act. For this purpose the Commissioner included in the taxpayer's income the income that SPH had derived from the assets which he had sold to it and assessed him accordingly.

Justice Corbett said:

“The four elements of section 103(1) which are required to warrant a determination by Inland Revenue are set out in SIR v Geustyn, Forsyth & Joubert (supra) at 571E-H. The first three requirements for the application of the above section were established. The only issue for decision before the court a quo was whether the taxpayer had discharged the onus of proving that the avoidance or the postponement of such liability or the reduction of the amount of such liability was not

*the sole or one of the main purposes of the transaction, operation or scheme.”*⁶⁰

Justice Corbett indicated that the main point made by the Commissioner’s counsel appeared to be that the taxpayer could not have failed to appreciate

⁶⁰ Section 103(1) states that:

Whenever the Commissioner is satisfied that any transaction, operation or scheme whether entered into or carried out before or after the commencement of this Act, and including a transaction, operation or scheme involving the alienation of property)--

a) has been entered into or carried out which has the effect of avoiding or postponing liability for the payment of **any tax, duty or levy imposed by this Act or any previous Income Tax Act, or of reducing the amount thereof**; and

[inserted after the Gallagher case]

b) having regard to the circumstances under which the transaction, operation or scheme

i) was entered into or carried out--

aa) in the case of a transaction, operation or scheme in the context of business, in a manner which would normally be employed for *bona fide* business purposes, other than the obtaining of a tax benefit; and

bb) in the case of a transaction, operation or scheme, being a transaction, operation or scheme not falling within provisions of item (aa) by means or in a manner which would not normally be employed in the entering into or carrying out of a transaction, operation or scheme of the nature of the transaction, operation or scheme in question; or

ii) has created rights or obligations which would not normally be created between persons dealing at arm's length under a transaction, operation or scheme of the nature of the transaction, operation or scheme in question; and

[Subpara (i) substituted by s.29(1)(a) of Act No.36 of 1996].

c) was entered into or carried out solely or mainly for the purposes of obtaining a tax benefit; and the Commissioner shall determine the liability for any tax, duty or levy imposed by this Act, and the amount thereof, as if the transaction, operation or scheme had not been entered into or carried out, or in such manner as in the circumstances of the case he deems appropriate for the prevention or diminution of such avoidance, postponement or reduction.

that, by divesting himself of considerable income-producing assets, he would substantially reduce his liability for income tax and that consequently such reduction must have been at least one of the main purposes of the scheme.

Justice Corbett said that it is improbable

- that the taxpayer could have been advised that there would be no income tax advantage to be derived from the scheme and
- that the taxpayer could have accepted the advice and embarked upon the scheme without having the reduction of his income tax as one of his main objectives.

Section 103(1) did not define the avoidance of estate duty as a tax that applied to this section at the time. Thus, the main purpose of the taxpayer was to avoid the payment of estate duty, and therefore, the appeal by the Commissioner was dismissed.

Section 103(1) was subsequently amended in the light of the *Gallagher* judgement to encompass the situation in which a transaction, operation or scheme is entered into or carried out solely or mainly for the purpose of avoiding, postponing or reducing the liability of a taxpayer for the payment of tax, duty or levy under any law administered by the Commissioner. As a result of the amended wording of the subsection “... *a scheme which has been entered into or carried out which has the effect of avoiding or postponing liability for the payment of any tax, duty or levy imposed by this Act or any previous Income Tax Act, or of reducing the amount thereof...*” the Commissioner can attack a scheme if its effect is to avoid any tax levied in

terms of the Income Tax Act and, in addition, the abnormality and other requirements of the section are satisfied.

4.3.1 Application of the principles derived from the *Gallagher* case

The *Hicklin*⁶¹ case concerned a sale by the taxpayer of all his shares in a private company that had distributable profits. His indebtedness to this company was eliminated with the sale of the shares.

The Commissioner raised the question whether the distributable profits were taxable as dividends in the taxpayer's hands and the requirements of section 103 had to be applied to the facts of the case. The High Court, referring to the *Gallagher* decision overruled the decision of the Special Tax Court and found that the Commissioner's reliance upon the provisions of section 103 of the Act was not maintainable, and accordingly, allowed the appeal with costs.

Although Justice Corbett did not deliver the judgement in *Burgess v CIR*⁶², he was a member of the court in the case. This case is a good example of a "formative" approach as applied by Justice Corbett during his years on the bench.

The taxpayer embarked on a scheme whereby money was borrowed from a bank and invested for a short period in an insurance policy. The value of the policy was expected to appreciate. At the end of the period of the insurance,

⁶¹ *Hicklin v SIR*, 1980, (1) SA 481 (A), 41 SATC 179

⁶² 1993, SA 161 (A), 55 SATC 185.

the bank would be repaid and the profit would be enjoyed by the taxpayer. The liability for the total interest accrued during the first year although interest was only payable in arrears. As no income was payable before the end of the first year, the liability to pay interest resulted in a tax loss which would be off-set against other income of the taxpayer. The insurance scheme had been marketed as a tax-saving device. The taxpayer sought to deduct his liability for interest in terms of section 11(a) upfront, but the Commissioner disallowed the deduction.

Grosskopf JA made it clear in his judgement that the Commissioner's decision was not based on section 103(1) of the Act. Therefore, the sole question to be decided was whether the taxpayer carried on a trade within the meaning of section 11(a). The Commissioner raised two arguments. Firstly, he suggested that the taxpayer's actual purpose in making the investment was to reap the reward which flowed from the fiscal advantage of the transaction. In other words, the scheme envisaged the enjoyment of a commercial return to be only an incidental benefit. Secondly, the particular investment could not amount to the carrying on of a trade that is sufficient to bring the deduction within the ambit of section 11(a). To support these arguments, the Commissioner mainly relied on English case law, particularly those cases that promoted a substance over form approach.

Grosskopf JA disagreed with the Commissioner on these points. He stated that:

“If a taxpayer pursues a course of conduct which, standing on its own, constitutes the carrying on of a trade, he would not ...cease to be

carrying on a trade merely because one of his purposes, or even his main purpose, in doing what he does is to obtain some tax advantage.”

On the basis of the facts, the Commissioner attempted to argue along the lines of Melamet J’s finding, in ITC 1496⁶³, that the package of agreements had no commercial basis and that the true purpose of the transaction was not to carry on a trade, but to save tax. In both cases the claiming of interest as a deduction up-front, created a tax loss. Overall the schemes were hardly profitable and in each case the main aim was to create a tax loss.

Had the court adopted a substance over form approach, which is similar to the approach adopted in the trilogy of English cases already discussed before in this chapter, the result might have been different. Unlike the United Kingdom, South Africa has a general anti-tax-avoidance section in its Income Tax Act.

According to Professor Davis⁶⁴, the *Burgess* case was an accurate reflection of the nature of the South African Income Tax Act as it was before the substance over form approach changed the face of anti-tax avoidance provisions adopted from England. The judgements in *Burgess* and *Gallagher* are good examples of the formative approach to the interpretation of fiscal legislation by Justice Corbett.

⁶³ 53 SATC 229

⁶⁴ An essay by D M Davis on *Substance over form in tax law: The contribution of Mr Justice Corbett. The Quest for Justice*, p. 151.

It should also be noted that section 103(1) was changed some time after this case, to include the *bona fide* business purposes test. According to this test the court should decide if a transaction was concluded like a normal business transaction, creating normal rights and liabilities, then it should not fail the “normality yardstick”. This test forces the court to consider the normality of the transaction from a business point of view, similar to that of the substance approach.

The new general anti-avoidance rule is inserted as Part IIA of Chapter III of the Income Tax Act and replaces the previous section 103⁶⁵. The GAAR opens by describing what an “impermissible avoidance arrangement” is in section 80A⁶⁶.

⁶⁵ Revenue Laws Amendment Act, No. 20 of 2006

⁶⁶ Section 80A provides that an avoidance arrangement (or an arrangement which results in a tax benefit) is an impermissible avoidance arrangement if:

1. Its sole or main purpose was to obtain a tax benefit; and
2. A tainted element is present. There are three tainted elements although their formulation may vary depending on the context in which an arrangement was carried out or entered into.
 - 2.1 Abnormality (sections 80A(a)(i), 80A(b) and 80(c)(i));
 - 2.2 Lack of commercial substance (section 80A(a)(ii)); or
 - 2.3 Misuse or abuse of the provisions of the Act (section 80A(c)(ii)).

The abnormality element is largely based on the previous section 103 and precedent developed in South Africa. The lack of commercial substance element is based upon precedent in both the United Kingdom and the United States and would adopt what the House of Lords has referred to as an “unblinkered” approach to complex multi-step “composite transactions.. The misuse or abuse element has its inspiration in

The powers that the Commissioner has with respect to an impermissible avoidance arrangement are set out in section 80B. The remaining provisions, from C to L, expand on these first two provisions and deal with certain procedural issues that arise.

The main elements of the new GAAR remain reduction of taxes and the abnormality of the transactions. The abnormality element is largely based on the previous section 103 and precedent developed in South Africa. The development of this part of the tax law has been retained in the new legislation.

4.4 SECTION 103(1) AS APPLIED TO LOANS TO SHAREHOLDERS FROM A COMPANY

The formative approach of Justice Corbett was also adopted in *Commissioner for Inland Revenue v Louw*⁶⁷. The taxpayer, a civil engineer, had practised in partnership with Van Wyk under the name Van Wyk and Louw. During 1966, this taxpayer and his partner decided to ‘incorporate’ the practice in an unlimited company. The company Van Wyk and Louw Incorporated was

Canadian and certain European jurisdictions approaches to impermissible tax avoidance. The two new elements are intended both to remedy the well-recognised weaknesses in the current abnormality requirement and to expand the scope of the GAAR to address as many forms of impermissible tax avoidance as possible.

⁶⁷ 1983 (3) SA 551(A), 45 SATC 113.

formed, which bought the business from the partnership. The purchase consideration was to be paid by the company, partly by means of an allotment of shares to the erstwhile partners and partly by crediting loan accounts in their names in the books of the company.

Immediately after incorporation, the directors' loan accounts, representing a portion of the purchase price, were in credit. Subsequently, unsecured non interest-bearing loans that the company had made to the directors eroded these credits with the result that by approximately 1971/1972 the directors' loan accounts were all in debit. Furthermore, the amounts that the taxpayer received from the company for salary and dividends were materially less than the income which had accrued to him as a partner in the partnership.

The Commissioner issued revised assessments for the 1966 and 1967 tax years, including the aforementioned proportion of the share of the company's income, with the company itself being regarded as having no income.

Corbett JA delivered the judgement. He found nothing wrong with the fact that the partnership changed to a company as it was normal business practice to do so⁶⁸. He held that the large after-tax profits of the company and the disparity between, on the one hand, the taxpayer's yearly aggregate of salary and dividends and, on the other, his partnership income, made it very probable that if the taxpayer and his co-directors had not received the amounts by way of loans, they would have received them by way of additional salary and/or dividends. It was furthermore upheld that this probability was confirmed by the co-mingling of salary, dividends and loans in the books of the company. In

⁶⁸ See *SIR v Geustyn, Forsyth and Joubert*, 1971, 33 SATC 113

the circumstances, there was only a remote possibility of the loans being called up by the company and the taxpayer's contention of a 'reserve' upon which the company could draw in time of need was untenable. Accordingly, the effect of the loan transactions was to avoid or postpone (but probably only to postpone) liability for income tax and therefore section 103(1) applied.

By applying the four tests contained in section 103(1), the abnormality of the transactions was proved. On an examination of the facts, it was found that the cumulative effect of the evidence indicated that, had the loans to directors not been made, the taxpayer and his co-directors would have received equal amounts, or amounts equal to a substantial proportion of such loans, in the form of either salary or dividends. This was an application of the formative and literal approach. By considering the facts of the case, the avoidance of tax was proved.

4.4.1 Application of the 'test of normality' in the *Louw* case

The formative approach that was applied by Justice Corbett in the *Louw* case and his reference to the "normality yardstick" between parties to a transaction was approved and applied in several cases thereafter.

The *Louw* case was discussed in ITC 1542⁶⁹. The taxpayers incorporated a second-hand car venture and then sold their goodwill ("*drawing-power*") to a company. The question that arose was whether the consideration received

⁶⁹ (1989) 54 SATC 417 (O).

constituted 'know-how' in terms of paragraph (gA) of the definition of *gross income* in section 1 of the Act and therefore of a revenue nature.

It was held that the consideration that the taxpayers received for the sale of their goodwill was of a capital nature and therefore not taxable as the receipt did not fall within the ambit of paragraph (gA) of the definition of gross income. Furthermore, it was held that the decision in *Louw* did not support the contention that the provisions of section 103 were applicable to the facts of the case. The following specific mention was made of Justice Corbett's *dictum*⁷⁰ in respect of the test of section 103:

“In such a case should the court, in applying the ‘normality’ yardstick, take account of the special relationship between the erstwhile partners and the company which they have formed, or ignore it and apply the yardstick as though the company were a stranger? I do not see how the court can ignore this special relationship and yet give proper effect to the concluding words of section 103(1).”

“For it is of the very nature of the incorporation scheme that the company to which the practice is sold by the partners will have as its shareholders and directors the self-same partners and will be controlled by them. Those are the realities of the situation. Moreover, it must be borne in mind that in a case such as the present, the transaction is a multiparty one to which all the partners and the company are parties; and each partner contracts both with the company and his fellow partners and seeks to extract from the transaction the best possible advantage for himself.”

⁷⁰ 54 SATC 417, p. 423.

The judgement delivered in ITC 1625⁷¹ also cites and discusses the *Louw* case. The taxpayer–company deducted interest on the money which it had borrowed to pay a portion of the purchase price of immovable property from which it derived rental income. The Commissioner contended that the real intention of the parties was not that the taxpayer should acquire the property in question from the existing close corporation, but simply that the members of the close corporation should derive the benefit of the enhanced market value of the property. It was questioned whether the taxpayer had the honest intention of purchasing the property and whether the existing close corporation had the honest intention of selling it.

The court relied on the observations of Corbett JA in *Louw* to decide whether section 103 should be applied. It was held that no abnormal rights or obligations were created and that therefore section 103 could not be applied.

Another case in which the principles of the *Louw* case were applied, was ITC 1636⁷². In that case, the taxpayer disposed of its assets to the lessor and then leased those assets in a sale and leaseback agreement. The taxpayer claimed the deduction of the rental paid in terms of section 11(a). The Commissioner disputed the scheme on the grounds that the transactions concerned were simulated and, alternatively, that they ought to be ignored in terms of section 103(1). This argument was based on the fact that the lessor, a financial institution, took transfer of ownership of the assets, while the taxpayer carried all the risk associated with ownership. The court held that the agreements in

⁷¹ 1995, 59 SATC 383.

⁷² 1997, 60 SATC 267.

question were genuine sale and lease-back agreements. One of the determining factors was that the parties were not “connected” parties.

The court also applied the normality test that was used in the *Louw* case. In determining whether any tax avoidance was effected in the *Louw* case, Justice Corbett adopted what may be termed a “but for” test⁷³. He phrased it as follows

“Ask oneself the question whether, but for the loans, equivalent or even lesser amounts would probably have been received by the taxpayer in a taxable form, that is as salary or dividend.”

The following was said in the *Louw* case⁷⁴ regarding the application of the normality (the “but for”) test:

“The question as to what the company, directed by the taxpayer and his co-shareholders, would have done had the directors’ loans not been made, was not canvassed in evidence. This is not altogether surprising. The ipse dixit of the taxpayer in answer to this hypothetical and essentially controversial question could hardly have carried much weight. The answer to the question must rather be sought in the inference to be drawn, as a matter of probability, from the known and undisputed facts.”

⁷³ 45 SATC 113, p. 579.

⁷⁴ 45 SATC 113, p. 579.

4.4.2 Conclusion regarding *Louw*

Whereas the House of Lords, in *Duke of Westminster*, adopted a “literal” approach to interpreting tax legislation, the trilogy of cases that commenced with *Ramsay* (supra) followed a “purposive” approach to interpretation. The court searched for the legislative purpose that applied in the introduction of the legislation and, having found it, based its interpretation on it. In *CIR v Louw*, Corbett JA was confronted with this approach. According to Professor Davis, Corbett JA adopted a literal approach to the interpretation of section 103(1). The general anti-tax-avoidance section, that is section 103(1), contained four separate requirements that had to be fulfilled before Revenue could successfully apply it to set aside what was otherwise acknowledged to be a legal transaction.

Section 103(1)(b)(ii) provided that the transaction, operation or scheme in question should have created rights or obligations which would not normally be created between two persons who deal at arm’s length in a transaction, operation or scheme of the nature of the transaction, operation or scheme concerned. The section sets out the so-called “normality” requirement. The question that arose, is what was meant by a “normal” transaction.

In dealing with an argument by Revenue in the case of the conversion of a professional partnership into a company, with consequent tax savings, Corbett JA (as he then was), concluded as follows in delivering the unanimous judgement of the court⁷⁵ that in applying the “normality” yardstick, the court

⁷⁵ 45 SATC 113 at page 137 and 138

cannot ignore the special relationship and yet give proper effect to the words of section 103 (1)(b). For it is the very nature of the incorporation scheme that the company to which the practice is sold by the partners, will have as its shareholders and directors the self-same partners and will be controlled by them. The transaction is a multiparty one to which all the partners and the company were parties; and each partner contracted both with the company and his fellow partner and sought to extract from the transaction the best possible advantage for himself.

The judgement illustrates how, in reaching his decision, Justice Corbett adopted a literal approach to the words of the section. In this way he introduced a contextualized objective test for ascertaining normality.

Applying only a subjective test (testing the taxpayer's intention) would take a considerable part of the "sting" out of section 103(1) and would, in many cases, make it exceedingly difficult for Revenue to succeed in applying the section.

Professor Davis⁷⁶ states that not all our courts have adopted this subjective approach to section 103(1). In ITC 1496⁷⁷, the taxpayer made an investment in a plantation venture by joining an *en commandite* partnership, which had been set up to carry on the business of timber-plantation farming for an indefinite period. The promoters of the scheme had created several

⁷⁶ An essay by D M Davis on *Substance over form in tax law: The contribution of Mr Justice Corbett. The quest for justice*, p.153.

⁷⁷ ITC 1496 (1991), 53 SATC 229

partnerships, each consisting of fewer than twenty partners. Four partnerships had been set up. A total of 72 investors as well as one managing partner had entered into these partnerships. Each partner was expected to make a contribution to the working capital of the partnership. In order to raise this money, the taxpayer borrowed funds from the bank and was required to issue a promissory note for the amount borrowed plus the total interest compounded over the period. The taxpayer then attempted to deduct in full the working capital contribution, as well as the total amount of interest in terms of section 11(a), in conjunction with section 23(g), of the Income Tax Act.

Revenue disallowed this deduction in terms of section 103(1) of the Act. Mr Justice Melamet upheld Revenue's approach. From an analysis of the facts, he found that⁷⁸:

"...The transactions were entered into and carried out in a manner which would not normally be employed in the entering into or carrying out of transactions of a partnership or partnerships and further had created certain rights and obligations not normally created between persons dealing at arms length in a scheme or transactions of this nature."

Professor Davis points out⁷⁹ that, although Melamet J pointed out a number of abnormalities in the facts, no attempt was made to compare the particular transactions with transactions of a similar nature, that is, other plantation

⁷⁸ ITC 1496 (1991), 53 SATC 229 at p 253D

⁷⁹ An essay by D M Davis on *Substance over form in tax law: The contribution of Mr Justice Corbett. The quest for justice*, p.153.

ventures. Melamet J's approach appeared to be that because the "*scheme in the present instance was designed to exploit what was thought to be loopholes in the Income Tax Act and hence, as the purpose of the transaction was to save or avoid tax, there was no need to contextualise the nature of the transactions, for by definition, they were artificial and contrived.*"⁸⁰

Whereas Corbett JA's approach in the *Louw* judgement amounted to an invitation to the courts to examine the context within which the transaction in question takes place and to classify the normality of the transactions in terms of the *genus* of such transactions, Melamet J appears to have confused the purpose and the normality requirements.

In brief, once the transaction has been entered into with the purpose of saving tax, there would appear to be little need to investigate the context in which the transaction was entered into in order to determine normality. Professor Davis submits that if Melamet J had adopted the approach that was applied in the *Louw* case, the evidence of comparable partnerships and the manner in which their transactions were structured would have been of crucial importance to the determination of whether the partnership in ITC 1496 had engaged in an abnormal transaction. *Louw's* case was not discussed or applied in ITC 1496. As the partnership in ITC1496 may have been considered not abnormal compared with similar partnerships, he submits, that had there been an appeal, the outcome of ITC 1496 might have been reversed, unless valid reasons could be given for not applying the principles contained in the *Louw* case. Unfortunately ITC 1496 was never taken to the High Court of Appeal.

⁸⁰ ITC 1496,1991, 53 SATC 229 at p 254B

According to Silke⁸¹, the normality or abnormality of a transaction should not be judged solely in terms of whether the parties are independent persons who deal with one another at arm's length. This is an important factor that should be taken into consideration, but it is not necessarily conclusive. It could well be that, in a particular transaction between two parties who are not independent persons that deal at arm's length, the manner and means that is contemplated in section 103(1)(b)(i) may be the normal procedure for that particular transaction. For example, it is not an abnormal arrangement for a father to sell assets to his child or for a sole beneficial shareholder in a company to sell the assets to his company and to leave the purchase price in the form of an interest-free loan. But the requirements of section 103(1)(b)(ii) should also be satisfied, namely that the transaction should not have created rights or obligations for persons that would not normally be created for persons who deal at arm's length. Therefore, because the father or the sole shareholder has left the purchase price in the form of an interest-free loan, it could be held that the transaction created a right that would not normally be created for persons who deal at arm's length; that the taxpayer has not satisfied the requirement of normality; and, if the avoidance of tax were the sole or main purpose, then section 103(1) should apply. It is imperative that the transaction should not only be judged in terms of the manner in which it was entered into or carried out, but also in terms of the rights or obligations that it creates. Even if the method that was adopted might be regarded as being normal, the taxpayer might still have failed to satisfy the requirement of normality if any of the rights or obligations that were created should prove to

⁸¹ Silke, *The test for normality*, chapter 19.13.

be abnormal. The rights or obligations should be those that would normally be created for persons who deal at arm's length in a similar transaction.

The circumstances under which the transaction was entered into or carried out as well as its nature should be considered. It was for this reason that in *CIR v Louw* the control exercised by the shareholders over the company was a factor that was favourably considered by the court regarding the question about the normality of the rights or obligations created upon their sale of their professional practice to the company.

If a shareholder transfers assets to a company that cannot pay him for them with the object of carrying out a transaction for the purpose of avoiding tax, he would, *prima facie*, be inviting the application of section 103(1). For example, should he sell those assets at values that are less than their current market price or if he should leave the purchase price as an interest-free loan, then he would create rights or obligations that would not normally be created by persons who deal at arm's length. However, exceptions do apply, for example, it could be considered normal for relatives not to charge interest to one another.

Developments subsequent to *Louw* have resulted in amendments to section 103(1). The substance of a scheme should be determined in order to test its "normality", but only in relation to business transactions. This amendment would not, however, have changed the outcome of the *Louw* case. The "*normality yardstick*" that was developed and applied by Justice Corbett is still used as a valid principle in the application of section 103(1) in non-business schemes and transactions.

CHAPTER 5 **GROSS INCOME – CAPITAL VERSUS REVENUE**
RECEIPTS AND SOURCE

5.1 **INTRODUCTION**

In this chapter, the judgements of Justice Corbett delivered in relation to:

- Whether a receipt is of a capital or revenue nature;
- the apportionment of receipts between capital and revenue; and
- the source of income

will be discussed.

Capital v revenue receipts

The definition of gross income in the Income Tax Act states that receipts or accruals of a capital nature are not included in the definition and are therefore not subject to income tax. However, since 2001 all capital gains are subject to Capital Gains Tax in terms of section 26A read together with the Eighth Schedule of the Act. Before 2001 it was very beneficial for the taxpayer to prove the capital nature of the profit that he had made on the sale of an asset, as it was not subject to taxation. The beneficial rewards of having a receipt classified as being of a capital nature are still available as only twenty five percent of a capital gain is included in the individual taxpayer's taxable income, unless the capital gain is specifically excluded from being taxable income, for example, the capital gain made on certain personal-use assets.

Justice Corbett could not escape the capital-versus-revenue tussle between taxpayers and the revenue authorities. He delivered judgements in the following three cases regarding the issue of capital versus revenue: *JM Malone Trust*⁸², *Elandheuwel Farming*⁸³ and *Rile Investments*⁸⁴. These cases mainly cover the question whether the profit made on the sale of property in a property company is taxable. These cases are discussed separately in paragraph 5.2 of this chapter.

Apportionment of receipts between capital and revenue

In *Tuck*⁸⁵, Justice Corbett made an apportionment between capital and revenue in a case in which a taxpayer received a single lump sum payment. Prior to this case, it was generally accepted that a receipt should be considered to be either capital or revenue in nature and that it could not be apportioned.

Source of income

In January 2001, South Africa introduced the principle of residence based taxation⁸⁶ and changed the basis of taxation from the “source of the income”

⁸² *JM Malone Trust v Secretary for Inland Revenue*, 1977 (A), 39 SATC 83

⁸³ *Elandsheuwel Farming (Edms) Bpk v. SIR*, 1977 (A), 39 SATC 163

⁸⁴ *Secretary for Inland Revenue v Rile Investments (Pty) Ltd*, 1978 (3) SA 732(A), 40 SATC 135

⁸⁵ *Tuck v Commissioner for Inland Revenue*, 1988 (3) SA 819(A), 50 SATC 98

⁸⁶ The definition of gross income was changed to include “*all income received by residents of South Africa*”.

to “the residence of the person receiving the income”. Thus the source of income has now become of relevance only in respect of non-residents who are only taxed on income that is derived from a South African source. However, the judgement of Justice Corbett in *Essential Sterolin Products (Pty) Ltd v Commissioner for Inland Revenue*, remains one of the leading cases dealing with the issue of establishing the source of income.

5.1.1 Receipts in a realisation company or a trust are of a capital nature

In *JM Malone Trust v Secretary for Inland Revenue*⁸⁷, the taxpayer formed a trust which made substantial profits on the sale of erven in a township which it owned.

The material conditions of the trust deed which were relevant to this appeal read as follows:

*“The objects for which the Trust is established shall be:
...to purchase immovable property and take transfer of such properties
or land into the name of the Trust and to sell such properties or land
when the Trustee considers it necessary or desirable to do so.”*

After the taxpayer’s death, the executor experienced difficulty in completing the establishment of the township and accordingly transferred the property to the trust. At the hearing before the Special Court, the executor testified that the purpose of clause 2(a) of the trust deed was to enable the trust to acquire a residence for the taxpayer. This would occur after the demolition of the

⁸⁷ 1977 (A), 39 SATC 83

existing dwelling on the property, consequent upon the layout of the township. However, the trust had not acquired any property other than the township property concerned.

It was held that the correct conclusion to be drawn from the facts was that, instead of himself implementing his resolve to realise the property through the township scheme, the taxpayer (or his estate) had created the trust as a vehicle for such realisation and to introduce additional safeguards for his children. Therefore the trust was purely a realisation trust within the principles espoused in the *Berea West*⁸⁸ case.

In the *Berea West* case, a realisation company was used to realise a capital asset without falling foul of the “crossing of the Rubicon” principle⁸⁹. Realisation companies now have limited application since the introduction of Capital Gains Tax. Paragraph 12(2)(c) of the Eighth Schedule of the Income Tax Act provides for the valuation of property when there is a change in the intention in regard to the use to which an asset will be put, for example, a change from holding it as a capital asset to holding it as a revenue asset or *vice*

⁸⁸ *Berea West Estates v SIR* (1976 AD), 38 SATC 43 See also *Realization Company v COT* 1951 (1) SA 177 (SR), (1950 SR 182), 17 SATC 139; *C H Rand v Alberni Land Co Ltd* 7, TC 629 and *Commissioner of Taxes v British Australian Wool Realisation Association Ltd* [1931] AC. In ITC 1450, 1988, 51 SATC 70, and *CIR v Pick ‘n Pay Employee Share Trust*, 1992 AD, 54 SATC 271, the courts held that the proceeds on the sale of shares were capital because the shares were not acquired in a profit-making scheme.

⁸⁹ See *Natal Estates Ltd v SIR*, 37 SATC 193

versa. This enables a taxpayer to protect his capital profit. Current legislation thus allows protection of the vested capital profit. No longer does the “all or nothing” approach apply, as was the case in *Berea West* and *Natal Estates*.

In the *Malone* case, Justice Corbett applied the principle of a realisation company, which principle had been established in the *Berea West* case (*supra*). The object of the trust was clearly stated as being a realisation trust of an estate. This was also the key element in the *Berea West* case.

As discussed in a preceding section, Justice Corbett favoured the formative approach. Therefore it was not surprising that in this case he also applied this philosophy. Nevertheless, the facts of the case were simply that the realisation of property that had been in the family for a very long time were regarded as being capital in nature. No real attempt had been made to enter into a profit-making scheme, although the reason for the lack of such an attempt may have been a shortage of cash to fund a scheme of that nature.

Very few references have been made to this case as the facts pertaining to it are similar to that of the *Berea West* case and the judgement of the court followed the precedent that had been set in the *Berea West* case.

5.1.2 A company is not independent of its shareholders when the nature of a transaction is to be determined.

In *Elandsheuwel Farming (Edms) Bpk v SIR*⁹⁰, the taxpayer company had been formed to acquire a farm. The shareholders were members of the same family. The company let the farm to one of the shareholders who farmed on it for a number of years. All the shareholders later sold their shares to D and his wife. In the same month, the purchasers sold eighty percent of their shares at the same price to a number of other persons. D and the other shareholders had previously been associated with companies that had engaged in the business of buying and selling land. Simultaneously there were rumours that a property developer was interested in acquiring the land from the company for the purpose of development in the area.

The shareholders held a meeting at which they were informed by a shareholder, who had had dealings with the developer, that the latter was prepared to pay a considerable price for the land. No contract was entered into with the developer. Some five months later the shareholders decided that the property should be offered to the Klerksdorp Municipality. The latter bought the property. The company enjoyed a net profit on the sale of the land.

The Secretary for Inland Revenue taxed the company on the profit that it had made on the sale of the property. The majority of the judges on the bench⁹¹ held that the only true conclusion that could be reached from the evidence was

⁹⁰ 1977 (A), 39 SATC 163

⁹¹ Wessels, Trollip and Hofmeyer JJA.

that the company had originally acquired the property as a fixed asset, but that the intention had changed to that of operating a business that employs the property as its trading stock.

In his dissenting judgement⁹², Corbett JA was of the opinion that the court *a quo* (of which the judgement had been upheld by the majority of the Appellate Division) had

“failed to properly distinguish between the intentions of the ...[D] group in acquiring their shares in the taxpayer company and the intentions manifested by them as directors, in the conduct of the affairs of the company”.

While the majority of the judges found no difficulty in lifting the corporate veil and treated the company as if it were synonymous with its shareholders, Corbett JA, using the formalistic approach, made a clear distinction between a company and its shareholders. He said:

“What they [the shareholders] purchased, the shares and the loan account, they at all material times retained. There was no re-sale of items of property, either at a profit or at all. What was eventually sold was property belonging to the taxpayer company and the proceeds of this sale accrued not to the shareholders but to the company. It is true that the company, guided by the directors, lent an amount representing the major portion of the proceeds to its shareholders.... These proceeds could never lawfully become the property of the shareholders: they had to be carried to a capital reserve.”

⁹² With which Kotze JA concurred.

The separation of the activities and intentions of the shareholders from those of the company is hardly the approach which would be adopted by a judge following a substance-over-form approach. The substance of the *Elandsheuwel* transaction was that the individual shareholders benefited from the proceeds of the property that was owned by the company. The company entered into this property transaction as a result of the change of its shareholding. To avoid paying tax, the taxpayer company had to convince the court that there is an important legal distinction between the intention of the company and that of its shareholders.

While the majority refused to be persuaded, Mr Justice Corbett's approach confirmed that there is scope for a formalistic argument as far as tax legislation is concerned⁹³.

The fundamental issue for the taxpayers in *Elandsheuwel* was whether a company is independent of its shareholders when there is more than one shareholder? Justice Corbett's minority approach was to uphold the independence of the company. His approach has been referred to in several subsequent cases.

⁹³ *The Quest for Justice*, An essay by D M Davis on *Substance over Form in Tax Law: The Contribution of Mr Justice Corbett*, p. 155.

5.1.2.1 Application of the *Elandsheuwel* case - distinction between the shareholders and the company

In the following cases, both local and international, some support but mostly opposition, has been found for Justice Corbett's approach, namely, that a clear distinction should be made between the shareholder and the company in which he or she owns shares.

In the *Malan* case⁹⁴ a company, the shareholders of which were a consortium of five persons of which the taxpayer was one, had obtained an option to purchase a farm situated near Vredenburg and Saldanha. This farm was in an area for which three large development projects with ancillary industrial areas were then envisaged. The consortium intended to exercise the option through the company on the abovementioned property, if satisfied that the farm had potential for development as an industrial township.

A third party, NK Properties Ltd, offered to purchase 51 per cent of the consortium's shares in the company. In support of the contention that the profit in issue was a capital accrual, reliance was placed upon the testimony of the taxpayer as showing that he had held his shares in the company as a capital asset to earn income, and it was submitted that the transaction concluded with NK Properties Ltd amounted to the acquisition of the desired 'capital-rich partner' in the project of developing the property as an industrial area.

⁹⁴ *Malan v KBI*, 43 SATC 1

In the evidence given by the taxpayer, it was indicated that his intention was to develop an industrial township through the company and to distribute the resultant profits in dividends to its shareholders. The shareholders were basically opposed to selling their shares; it was, however, the only practical method to raise the necessary additional capital. The court found that in the absence of any adverse credibility finding, the court should accept the taxpayer's evidence. The taxpayer had thus discharged the onus imposed on him in terms of section 82 and the appeal was accordingly allowed with costs.

Reference was made to *Elandsheuwel*. However, it is submitted that the *Malan* case is an application of the minority decision in *Elandsheuwel*. The shareholders in the company, including Malan, sold their shares and the profit on the sale of shares was regarded as capital in nature.

In ITC 1406⁹⁵ the *Elandsheuwel* case was cited, but distinguished. The court was required to decide whether the profit that a private company had made on the sale of property was of a revenue or of a capital nature. The company had only two shareholders and they had an equal shareholding. The property had been held as an investment since 1968 and was sold in 1980. The new shareholder, who acquired a 50 per cent shareholding in 1978, had always desired to sell the property. Based on the facts, no change in the company's intention could be established. The profit at issue was held not to be taxable.

⁹⁵ 1985 (T), 48 SATC 12 at 14 & 16

In delivering the judgment of the court, the President, Nestadt J, said that when the taxpayer concerned is a company, which can only think and act through the medium of living beings, then, depending on the circumstances, evidence of the state of mind or intention of the persons in effective control of the company may provide an important indication as to the intention of the company itself in relation to the matters in issue.⁹⁶ Moreover, account should be taken of changes that occur in shareholding and which cause the control of the company to pass into new hands, because the advent of new controllers may bring about a change in the intentions of the company (*Elandsheuwel Farming*).

When the taxpayer is a company, the objectives of the company that are formulated in its memorandum of association is another consideration of some importance. However, the widespread practice in South Africa of framing objectives in very wide terms may reduce the significance of this factor.

In continuing, Justice Nestadt stated that there was no reason not to accept the original shareholder's testimony that his intention to retain the property as an investment had never changed until the decision was taken to sell it. He had at no time consented to any profit-making scheme involving the company's fixed property. The speculative dealings in which he and the new shareholder had engaged were not *qua* shareholders and directors of the taxpayer company.

⁹⁶ Secretary for Inland Revenue v Trust Bank of Africa Ltd, 1975(2) SA 652(A), 37 SATC 87 at 669

In these circumstances, Justice Nestadt concluded that, based on the principle that the taxpayer company, as a legal *persona*, has its own identity that is separate from that of its shareholders and to have regard to them would be tantamount to piercing the corporate veil to an unjustified extent. As far as the taxpayer was concerned, it never proceeded to the business of trading. The sale to the new shareholder merely triggered a decision by it to realise, for sound commercial reasons, its property, which, until then, had been held as an investment. In other words, there was merely a decision to sell.

This judgement distinguishes ITC 1406 from the majority decision in the *Elandsheuwel* case. Nestadt J did not read the *Elandsheuwel* decision as an indication that the mere fact that the new shareholders were land speculators was sufficient proof that the taxpayer company changed its intention to that of a taxable, profit-making scheme. New factors had intervened in *Elandsheuwel*. They are referred to by Wessels JA ⁹⁷ and by Trollip JA⁹⁸. The entire shareholding had changed. The use of the property as a farm was discontinued. The new shareholders took the initiative in disposing of it and the only reason to do so was to make a profit.

However, in ITC 1406, one shareholder, who owned fifty percent of the shareholding, remained the same, while the second shareholder sold his fifty percent stake in the company. The use of the property in the company had not changed. On the evidence presented, a purchaser was not actively sought for the property. There was indeed no reason to sell.

⁹⁷ on p.112

⁹⁸ on p.115

The majority decision in the *Elandsheuwel* case, however, was applied in ITC 1418⁹⁹. The taxpayer, an individual, made a profit on the sale of immovable property. The property was acquired to avoid litigation that would arise from the previously aborted sale. The court had to decide whether the profit that was made was of a revenue or of a capital nature. Intention was the relevant criterion. Intention was to be inferred from the acts and the dealings in property by the taxpayer.

The court held that, by applying the principle established in *Elandsheuwel Farming*, the Commissioner had correctly regarded the sum concerned as revenue. In delivering the judgement of the court, the President, Conradie AJ, specifically referred to Justice Corbett's minority judgement as follows:

“The legal problem which arises is this. Where a taxpayer acknowledges that a property is purchased for the purpose of immediate resale, but denies that his motive was to make a profit on the resale, whether that property is held on capital or on revenue account, I think one should keep a necessary perspective on the expression ‘for purpose of resale at a profit’. It is an expression which is commonly used in income tax cases. It does not mean that one must necessarily make a profit by virtue of the resale. It does not mean that one’s motive for purchasing the property must necessarily be to make a profit. All that it means is that the taxpayer treats the asset as part of his floating capital and not as part of his fixed capital. In this regard, Corbett JA in his judgment in Elandsheuwel Farming, sets out the matter very clearly.”

⁹⁹ (1986), 49 SATC 42 on p. 44

Conradie AJ said that when a taxpayer sells property, the question regarding whether the profit that is derived from the sale is taxable in his hands, depends on the further enquiry as to whether the sale amounted to the realisation of a capital asset or whether it was the sale of an asset in the course of carrying on a business or in pursuance of a profit-making scheme. When a single transaction is involved, it is usually more appropriate to limit the enquiry to the simple alternatives of a capital realisation or a profit-making scheme. In its normal and most straightforward form, the latter connotes the acquisition of an asset for the purpose of reselling it at a profit. This profit is then the result of the productive turn-over of the capital that is represented by the asset and consequently falls into the category of income. The asset in effect constitutes the taxpayer's stock-in-trade or floating capital. In contrast to this the sale of an asset that was acquired with a view to holding it either in a non-productive state or in order to derive income from the productive use thereof, and is in fact so held, constitutes a realisation of fixed capital and the proceeds are an accrual of a capital nature.

Justice Conradie proceeded to explain that the passage he had referred to earlier from Justice Corbett's minority judgement in *Elandsheuwel*, makes it quite clear that the phrase "for the purpose of resale at a profit" is simply another way of saying that the asset is held as stock-in-trade or as part of the taxpayer's floating capital. Floating capital is capital that is not turned to account by holding it and making productive use of it, but by disposing of it. He explained that when a taxpayer intends not to hold the asset as capital and to derive an income from its productive use, but to turn it into account by disposing of it, it appears that it cannot be said that that asset was held on capital account.

This distinction between floating capital and fixed capital to determine the capital or revenue nature of a receipt was, however, dismissed by the majority of the court in the *Pick n Pay Employee Share Trust* case¹⁰⁰. In that case the majority judgement used the profit making scheme principle as the main criteria for establishing whether a receipt is of a capital or a revenue nature. Although the taxpayer did not have the intention of making a profit, there was a continuous flow of share dealing activities and profit making was an important factor in the business. The court held that any receipts accruing to the Trust from the sale of shares to employees were purely fortuitous in the sense of being an incidental by-product. The sole purpose of acquiring and selling shares was to place them in the hands of eligible employees. The court therefore found the profit in the Trust to be of a capital nature.

5.1.2.2 Lifting of the corporate veil as applied in the United Kingdom

The following cases illustrate how the courts in the United Kingdom have approached the issue of capital versus revenue profits in relation to corporate and individual identity. Firstly, ownership of a company owning the assets is looked at. This was the point of debate in *Elandsheuwel*; if the shareholders controlled the company, were their intentions the intentions of the company? The general rule is that a controlling shareholder is normally associated with the actions and transactions of the company. Opposed to the controlling shareholder, minority shareholders are generally not responsible for the actions and transactions of a company in the United Kingdom. Minority

¹⁰⁰ CIR v Pick n Pay Employee Share Trust, 54 SATC 271 (A)

shareholders can therefore not derive any tax benefits, or tax losses, from a company. This was the issue in *Irving v Tesco Stores (Holdings) Ltd*¹⁰¹.

In that case, the taxpayer company entered into a scheme whereby its subsidiary was to buy a ship in partnership with the Shell group of companies. The object of the scheme was to enable the taxpayer company to claim the capital allowances incurred on the acquisition of the ship for 87% of the purchase price. In the UK, this group relief is possible as a tax loss can be transferred to another company in the same group, provided that the other company controls the affairs of that company.

The UK Income Tax Act defines “control” of a company as a power to conduct the company’s affairs by the holding of shares or possession of voting power or by virtue of control conferred by the articles of association, which are normally powers conferred on the directors.

It was held that Holdings did not have control over the affairs of the partnership and accordingly was not entitled to claim group tax relief in relation to the expenditure incurred by the purchase of the ship.

It appears that the majority shareholding does determine the intentions of the company. This is in contrast with the dissenting judgment of Justice Corbett in *Elandsheuwel*. Several individuals were shareholders of Elandsheuwel Farming (Edms) Bpk, the majority of them were involved in the buying and selling of property as a trade in their personal capacities. The shareholders

¹⁰¹ [1982] 881 ChD

who did not involve themselves with the trade in property were caught in the same net as the trading shareholders in *Elandsheuwel*.

5.1.2.3 Lifting of the corporate veil as applied in New Zealand

The approach in New Zealand¹⁰² is similar to that of the majority decision in *Elandsheuwel*.

In *Traveller & Ors v Commissioner of Inland Revenue*¹⁰³ the facts were similar to *Elandsheuwel* in that the company also changed shareholders whilst the property was a fixed asset in the company for several years.

The taxpayers were shareholders in the Kuratau Land Company Ltd (“the company”). The company owned approximately 10 acres of land on the shores of Lake Taupo, which either sublet the land or granted each shareholder a licence to occupy a section of the land. The company issued licences to shareholders to occupy their plots during 1960 to 1963.

It was resolved at the 1977 annual general meeting that the company would issue freehold titles and thereafter be liquidated. Neither the shareholders nor their predecessors were the beneficial and equitable owners of the sections

¹⁰² See also for “shareholders” and “intention”: *Rangatira Limited v Commissioner of Inland Revenue* (1994) 16 NZTC 11,197 High Court Wellington; *Taunton Syndicate v Commissioner of Inland Revenue* (1982) 5 NZTC 61;

¹⁰³ *Traveller & Ors v Commissioner of Inland Revenue* (1992) 14 NZTC 9, High Court Hamilton

prior to 1977. The resolution taken in 1977 was the first formal record that the shareholders desired to liquidate the company and receive a free title.

Although the company was aware that the shareholders were developing their sections, it was unaware that they were expending considerable time and money in reliance upon a common intention that freehold titles would be transferred to them when it was demanded. It is clear that the minority shareholders developed their land without the company being expected to know about it.

The taxation implications of liquidation and distribution *in specie* and the sale of sections of freehold land to non-company members were considered. The Commissioner claimed that if the company had wound up and distributed *in specie* the sections held by the shareholders, then he would deem the distribution to be a sale of the land at market price and the company would be taxed on the resulting profit. In addition, he would deem the distribution to be a dividend to shareholders, which was taxable at that stage.

The court held that the Commissioner had correctly regarded the transactions as constituting revenue. Although the treatment would be different in South Africa¹⁰⁴, this case shows that New Zealand does see the shareholders of a company as part of the company and not completely separate entities.

¹⁰⁴ In South Africa in a similar situation, the dividend would be exempt from tax in the hands of the shareholders; however, secondary tax on companies would be paid by the company on its revenue profits distributed.

As far as intention goes, New Zealand uses virtually the same tests as South Africa in determining whether a profit is of capital nature or not. This principle is reiterated in Case H101¹⁰⁵. The taxpayer was involved as a partner in two partnerships. The two partnerships purchased two adjoining dairy farms. Before finalisation of the transfer of the farms, they had become less enthusiastic about their venture because of personal reasons and the unsuitability of the farm for grazing. Their solicitor advised them to sell. The Commissioner assessed the taxpayer on the profits from the sale and the taxpayer objected. The issue was whether the taxpayer had purchased the farms with the purpose or intention to resell at a profit.

The court held that the partners' intentions and the structure of the purchase and sale transactions were fully consistent with a venture embarked upon with the intention of a short-term resale at a profit. The profit was therefore of a revenue nature and taxable.

5.1.2.4 Conclusion on *Elandsheuwel*

Tax avoidance schemes that have been devised to avoid tax by labelling revenue as a capital profit, have failed in the courts in various parts of the world. It used to be a good idea to place an investment in a property or shares, in a separate company. However, this scheme did not succeed in the case of *Elandsheuwel*, because the majority decision lifted the corporate veil on the

¹⁰⁵ Case H101 (1986) 8 NZTC 683

new shareholders who were also land speculators and taxed the profits of the company as revenue profits. Similar judgements have been given by the courts in the UK and New Zealand, as described in the examples given previously in this chapter. However, the lifting of the corporate veil has been criticised in cases where the investments were held as capital on a long term basis¹⁰⁶.

A minority judgment does not create a precedent, yet it can be persuasive. The minority judgement of Justice Corbett has been referred to more often than the majority judgement. Out of ten references by the courts to *Elandsheuwel*, six referred to Justice Corbett's minority judgement. Although later judgements on the proceeds of the sale of property have not in all instances followed the outcome of Justice Corbett's minority judgment, the rules that he laid down have been applied – only in very special circumstances should the corporate veil be pierced.

In *Elandsheuwel*¹⁰⁷, Justice Corbett identified three main criteria to decide if a profit on the sale of property by a company is taxable or not, namely:

Criterion 1: Is the company totally separate from its shareholders for tax purposes?

South African taxation differs from that in other countries in respect of the fact that in South Africa, taxable income and assessed losses cannot be transferred

¹⁰⁶ See *Berea West Estates (Pty) Ltd v CIR*, 38 SATC 62 and ITC 1418 discussed earlier in this chapter.

¹⁰⁷ *Elandsheuwel Farming (Edms) Bpk v SIR*, 39 SATC 163 at 181 to 186

between a company and its shareholders as is the case in countries such as New Zealand, Australia and the UK. In those countries the intention of each individual shareholder can be identified and dealt with separately. According to Nestadt J in ITC 1406 (*supra*):

“...Where the taxpayer concerned is a company, which can only think and act through the medium of living beings, then, depending on the circumstances, evidence of the state of mind or intention of the persons in effective control of the company may provide an important indication as to the intention of the company itself in relation to the matters in issue.¹⁰⁸ Another consideration of some importance in the case of a taxpayer which is a company is the objects of the company as formulated in its memorandum of association, although the well-known practice in South Africa of framing objects in very wide terms may, in a particular case, reduce the significance of this factor¹⁰⁹.”

It is submitted that if the memorandum of association clearly states that the company's intention is of a capital nature, then the intentions of the shareholders may be ignored. This principle was established in the *Berea West Estate* case (*supra*) and confirmed by Justice Corbett in the *JM Malone Trust* case (*supra*). Yet the *onus* remains on the taxpayer to prove to the court the real circumstances and what the real intention was.

Criterion 2: Does a change in shareholding change the company's intention?

¹⁰⁸ Secretary for Inland Revenue v. Trust Bank of Africa Ltd, 1975(2) SA 652(A), 37 SATC 87 on p. 669

¹⁰⁹ Natal Estates case (*supra*) on p. 197 F-H

The majority judgement in *Elandsheuwel*, rather than the minority judgement of Justice Corbett, has been accepted by our courts as correct. But each case depends upon the circumstances as was pointed out by the majority decision, namely:

“...account must be taken of changes in shareholding which cause control of the company to pass into new hands since the advent of new controllers may bring about a change in the intentions of the company.”¹¹⁰

In the *Elandsheuwel* case, the change in the shareholding accounted for more than 80% of the shareholding. It was therefore a change in the control of the company, and together with other factors present in that case, which lead to the piercing of the corporate veil. The change in the shareholding in ITC 1406 (supra) was only fifty percent of the shareholding and the conclusion was drawn that no piercing of the corporate veil was necessary as there had been no change in the control of the company.

Therefore, where there is a substantial change in shareholding, the minority shareholders' share of after-tax profit may be compromised. The change of control can bring about a change in intention.

The courts do not follow a formative approach when the intention of the company is being established, as was suggested should be done by Justice

¹¹⁰ Nestadt JA in ITC 1406, 48 SATC 12

Corbett in his minority judgement in *Elandsheuwel (supra)*. A wider approach is followed by the courts¹¹¹.

Criterion 3: Has the principle of substance of an agreement rather than its form been accepted by the judiciary?

Justice Corbett's minority judgement in *Elandsheuwel*'s decision did not accept the principle of substance over form. In most instances in subsequent cases the courts were keen to apply the substance over form rule¹¹² such as in the *Trust Bank* case where it was stated that the purpose for which a transaction was entered into can, in the case of a company, be proved as to the state of mind or intention of the persons in effective control of the affairs of the company.

In the *Malan* case (*supra*) the shareholders themselves convinced the court that their intention in holding shares in a property company was of a capital nature. The court looked at the contract of the sale of their shares in the property company to obtain more capital, as well as the fact that they had an intention to invest in the long term in this property company. In this case the individual shareholders were not taxed on the profit on the sale of their shares.

¹¹¹ See ITC1406, 48 SATC 12; ITC 1418, 49 SATC 42 and *CIR v Pick 'n' Pay Employee Share Trust*, 54 SATC 271 as discussed in # 5.1.2.1.

¹¹² See ITC 1418, 49 SATC 42 discussed earlier in this chapter, Also ITC 1406, *SIR v Trust Bank of Africa Ltd*, 1975(2) SA 652(A) at 669F, 48 SATC 12 and *C:SARS v Metlika Trading Ltd and Others*, 66 SATC 345

References have often been made to Justice Corbett's minority judgement in the *Elandsheuwel* case and the courts have applied the criteria laid down in his judgement to reach a verdict. His reasoning was legally sound, but in respect of the control of a company he was on the side of the minority shareholders who did not have a history of dealing in land. It has become apparent from the examples from the United Kingdom and New Zealand that the controlling shareholders do control the intentions of the company.

In a number of cases Mr Justice Corbett adopted a formative approach to applying tax law. This approach is probably best illustrated in his dissenting judgement in *Elandsheuwel*.

It is submitted that the majority judgement in *Elandtheuwel* had one shortcoming in that it resulted in the minority shareholders being treated the same way as the majority shareholders. The company was taxed on a profit on the sale of the property which was held for decades. Its long term investment, clearly of a capital nature, was taxed as if it were revenue. The minority shareholders should have been allowed to treat their investments as capital as they clearly had long term intentions with their shareholding in the property company.

A more equitable outcome would have been to value the property at the time of the change of intention. The capital profit arising at the stage of the change of intention would remain capital in nature. Profits arising after that date

would be revenue in nature. This is currently the position in terms of the Eighth Schedule¹¹³ to the Act.

5.1.3 Intention on the sale of land

In *Secretary for Inland Revenue v Rile Investments (Pty) Ltd*, 1978 (3) SA 732(A) 40 SATC 135, the taxpayer had acquired ownership of two properties. Between 1965 and 1969 many changes took place in the shareholding of the taxpayer company. By 1 April 1969 Nedbank had acquired effective control of the taxpayer and on 19 September 1969 the taxpayer sold the two properties to Nedbank Medical Centre Ltd (“NMC”) for R 300 000. The purchase price was paid as follows: R 76 000 in cash and by allotting and issuing to the taxpayer 448 000 shares (credited as fully paid up and having a nominal value of R 224 000) in NMC.

It was held by Corbett CJ that an analysis of the facts revealed that while the taxpayer’s original intention in acquiring the properties remained obscure and its intention might at the earlier stages of the development projects have been mixed (either to sell the properties at a profit or to hold them as a long-term investment – with neither intention dominant), it was established that as from 1 April 1969 it was the intention of all the taxpayer’s shareholders (including the controlling shareholder Nedbank) to treat the properties as a capital asset; and – rejecting the submission to the contrary by counsel for the Secretary – that there was sufficient evidence of more than a mere change of intention to

¹¹³ Paragraph 12(2)(c) of the Eighth Schedule treats the event as an acquisition when an asset commences “to be held by that person as trading stock”

justify the Special Court's finding that, at any rate after the advent of Nedbank, the said properties were held by the taxpayer as assets of a fixed capital nature. The court upheld the taxpayer's contention.

5.1.3.1 Application of the principle of *Rile Investments*

In *CIR v Malcomess Properties (Isando) (Pty) Ltd*, 53 SATC 153 at 164, 1991 (2) SA 27 (A), the taxpayer had acquired property in 1969 with the intention to hold it as a capital asset from which it would derive income by way of rentals. That intention remained unchanged until 1975 when the shareholders in the holding company resolved that it should be wound up and its assets (which included the property) be realised.

The profit derived from the sale of the property was held to be of a capital nature. The court relied on the statement in *Secretary for Inland Revenue v Trust Bank*¹¹⁴ that the purpose for which a transaction was entered into can, in the case of a company, be proved as to the state of mind or intention of the persons in effective control of the affairs of the company. The court also relied on the dictum by Corbett JA in *Rile Investments*: that where the company held property as long term capital, then the proceeds on the sale were capital in nature.

¹¹⁴ *Secretary for Inland Revenue v Trust Bank of Africa Ltd*, 1975(2) SA 652(A) at 669F

5.1.3.2 Conclusion on Rile Investments

According to Silke¹¹⁵ the following are important considerations in determining whether a profit made on the sale of land constitutes an accrual of a revenue nature: The intention of the taxpayer (owner) when he first acquired the land and later when he sold it; his activities in relation to the land up to the time of deciding to sell it; and the light which such activities may throw on the taxpayer's assertions regarding his intention¹¹⁶. When the taxpayer is a company, then, depending on the circumstances, evidence of the state of mind or intention of the persons in effective control of the company may provide an important indication as to the intention of the company itself. This is contrary to Justice Corbett's minority judgement in *Elandsheuwel* and in line with the majority judgement in that case. Thus, account should be taken of changes in shareholding which cause control of the company to pass into new hands, because the advent of new controllers may bring about a change in the intentions of the company, depending on the circumstances. Another consideration of some importance is the objects of the company as formulated in its memorandum. However, the well-known practice in South Africa of

¹¹⁵ Silke: Chapter 3.1: Intention – the golden rule, paragraph 651

¹¹⁶ In his dissenting judgment in *CIR v Richmond Estates (Pty) Ltd* 1956, (1) SA 602 (A), 20 SATC 355 at 365 Schreiner JA put the matter into perspective: “*There is no legislative provision that makes the intention of the taxpayer decisive of whether the receipt or accrual was of a capital nature or not. The decisions of [the Appellate Division of the Supreme Court] have recognized the importance of the intention with which property was acquired and have taken account of the possibility that a change of intention or policy may also affect the result.*”

formulating objects in very wide terms may, in a particular case, reduce the significance of this factor.

Ultimately the courts will consider whether any dominant factor may have caused the nature of a transaction to be capital or revenue, whether it was when the property was acquired, during the course of its possession or at the time of its sale. In *Rile Investments*, Justice Corbett considered the dominant intention at the time of the sale and the facts surrounding the sale. The fact that the major shareholder retained the property within its group after the sale was concluded was convincing evidence that the sale was not of a revenue nature and that the intention of the major shareholder was to have a longer term investment.

5.2 **APPORTIONMENT OF RECEIPTS BETWEEN CAPITAL AND REVENUE**

Until *Tuck v CIR*¹¹⁷, the view was that receipts received by a person were either of a capital nature or of a revenue nature. If it was revenue in nature, it was taxable at the normal tax rate. It was normally not possible for someone to have one receipt which was partly capital and partly revenue in nature. It was also not possible to have a receipt which is neither revenue nor capital - in *Pyott v CIR*¹¹⁸ Davis AJA said: “*This is a half-way house of which I have no knowledge*”. However, in *Tuck v Commissioner for Inland Revenue* Justice

¹¹⁷ 1988 (3) SA 819(A), 50 SATC 98

¹¹⁸ *Pyott Ltd v CIR* (1945 AD), 13 SATC 121

Corbett found it possible to apportion a receipt into its constituent components of capital and revenue.

The taxpayer, Mr Tuck, received 826 shares in American Home Products Corporation of New York ('American Home') in terms of what was called a "management incentive plan" ("Plan"). In assessing the taxpayer for income tax, the Commissioner for Inland Revenue included this amount in the taxpayer's taxable income. On appeal by the Commissioner, the court *a quo* held that the dominant purpose of the Plan was to reward excellence in management and to encourage employees to render such service. It furthermore held that the principles relating to the sterilisation of assets had no application and that no part of the receipts in issue was of a capital nature.

Counsel for the taxpayer submitted to the Appellate Division – with citations from cases in delict and the criminal law that deals with causation – that the causally relevant factor that resulted in the taxpayer's receipt of the shares was his compliance with the restraint; and that therefore the entire sum in issue was of a capital nature. As an alternative, counsel for the taxpayer submitted that the receipt of shares was attributable, at least in part, to observing the restraint; that an apportionment was competent; and that a 50/50 apportionment was appropriate in the circumstances.

Corbett JA held that:

- (i) the preferable criterion was the one that is stated in *Lever Bros*¹¹⁹, namely: What work, if any, did the taxpayer do in order to earn the receipt in question; what was the *quid pro quo* which he gave for the receipt?
- (iii) both elements were causally relevant factors and both were equally important.
- (iii) the element of service was plainly of a revenue nature, while the element of restraint was equally plainly of a capital nature,
- (iv) in the absence of any other acceptable basis of apportionment, a fifty-fifty apportionment would be fair and reasonable and therefore the taxpayer was only liable for the fifty percent portion relating to services rendered.

5.2.1 **Application of the apportionment principle in *Tuck***

The principle that apportionment is fair and reasonable, was referred to in several cases.

In ITC 1479¹²⁰ the taxpayer claimed a machinery investment allowance. It was held that where certain of the plant and machinery was used both for manufacture and other usage, then the use of the plant and machinery in the process of manufacture should be determined on the basis of the time spent by such plant and equipment in the process of manufacture in relation to the time spent in the process other than manufacture – an apportionment could then take place as suggested in *Tuck*.

¹¹⁹ CIR v *Lever Bros*, 1946 AD, 14 SATC 1 at 8 – 9

¹²⁰ 1989 (T), 52 SATC 264 at 275

In *CIR v VRD Investments (Pty) Ltd*¹²¹, the taxpayer and fellow distributors formed a consortium with the object of acquiring a competitor's business, selling off all its assets and then sharing the ensuing loss. The taxpayer then claimed a deduction of its share of the loss in terms of section 11(a). The question to be answered was whether the loss incurred in these circumstances was of a capital or revenue nature.

The court held that expenditure which is incurred in order to operate a business more economically is of a revenue rather than of a capital nature, provided that the expenditure is sufficiently closely connected to the income-earning operation of the business so as to be regarded as part of the cost of performing it. Expenditure incurred for the acquisition or recovery of a share in the market is typically of a capital nature. Justice Scott remarked:

"The question is: what apportionment should be made? No arithmetical basis for apportionment is possible but that does not preclude an apportionment from being made (see Tuck). In all the circumstances, it seems to me that an apportionment on the basis of 25% of the expenditure being of a capital nature would be fair and reasonable to both parties."

Justice Scott followed *Tuck* in sanctioning an arbitrary apportionment as any other form of apportionment did not seem to fit the circumstances.

¹²¹ 1993, (4) SA 330 (C), 55 SATC 368 at 381

In *C:SARS v McRae*¹²² the taxpayer received several lump sum payments from his employer. The question was whether the court *a quo* had correctly decided that one half of the amounts received by the taxpayer were of a capital nature and therefore did not constitute gross income. It was held that the applicable principles were those enunciated in *Tuck*. The taxpayer actually received benefits prior to termination of his employment, as was the case in *Tuck*. It was held, accordingly, that the apportionment made by the court *a quo* on the basis of 50% of such receipts constituting revenue income was correct.

Another application of *Tuck* was found in ITC 1725¹²³. The taxpayer, a dairy farmer, had received a lump sum payment being compensation for damages suffered by him for major harm caused to his farming operation as a result of defective feeds supplied to him. The taxpayer suffered both a loss of cattle and of milk production. His genetic breeding programme was damaged with a resulting loss of goodwill.

The court held that apportionment, on the basis of *Tuck*, was clearly deserving of application. Since there was more than one causally relevant factor to be considered, the court was entitled to rely upon the *dictum* in *Tuck* where Corbett JA (as he then was) said:

“What this court really has to determine is the causally relevant factor which resulted in the accrual to and the receipt by the taxpayer of the shares in question. It has been held that it is necessary to determine

¹²² 2001 (C), 64 SATC 1 at 6-7

¹²³ 2000 (C), 64 SATC 223 at 230-1

the ‘originating cause’ of amounts being received as income for the purpose of determining the ‘source’ of that income. . .”

The court held accordingly that the compensation paid to the taxpayer should be apportioned so that two-thirds was attributable to the loss on his genetic breeding program and one third to the loss of profits.

5.2.2 Conclusion on the principle of apportionment in *Tuck*

The application of the apportionment concept in the context of capital or revenue receipts or accruals is not in conflict with the proposition that all receipts by or accruals to the taxpayer should fall into either the one category or the other, “*there being no halfway house*”¹²⁴. There should, however, be a visible and legal means to split the income. Apportionment will only occur when there are two or more distinct legal *causae*, which give rise to a receipt or accrual, which consists of both a capital and revenue component.

An interesting question that emerges from the *Tuck* judgement is whether the applicability of the principle of apportionment can be extended to the area of source. The approach followed by the Court in the *Tuck* case, it is submitted, does not preclude this principle from being extended to the source of income. Corbett JA used the *Lever Bros’s* originating cause test in deciding that two legal *causae* existed. Therefore it is reasonable to expect that it is within the

¹²⁴ In *Pyott Ltd v CIR* 1945, AD 128, 13 SATC 121 Davis AJA, who delivered the judgement of the Appellate Division of the Supreme Court, refused to countenance the concept of an amount that was both ‘non-capital’ and ‘non-income’, describing it as a ‘half-way house’ of which he had no knowledge.

legal framework of the principles as laid down in the cases of *Tuck* and *Lever Brothers*, to apportion source.

The facts of these two cases were different and they dealt with different aspects of the definition of “gross income”, yet the *Lever Brothers* principle was applied in a way that was applicable to *Tuck* and the principle of apportionment, at least in the sphere of capital and revenue issues, has now been established in the South African tax law. This is also the case as regards the apportionment of expenditure, which is discussed in chapter 8.

Justice Corbett, it is submitted, developed the law relating to apportionment of income based on sound legal and equitable principles.

5.3 SOURCE OF INCOME

In 2001, South Africa changed from taxing receipts based on the source of the receipts to a system based on the residence of a taxpayer. This change in regime reduced the importance of the source of income for South African residents for tax purposes. Nevertheless, for non-residents, source still remains an important principle.

In *Essential Sterolin Products (Pty) Ltd v Commissioner for Inland Revenue*¹²⁵, the taxpayer, a South African resident, had registered a medicine in West Germany through Hoyer and Company (‘Hoyer’). The taxpayer also

¹²⁵ 1993 (4) SA 859 (A), 55 SATC 357

established the I Company, which was registered in Switzerland, to market its product.

A “sale and manufacturing agreement” was entered into whereby Hoyer would acquire all the issued shares in the I Company. A clause that related to the payment of the consideration included an amount of DM 4 million that was due in terms of a conditional right of the buyer to manufacture before the licence was transferred. The Commissioner included the DM 4 million (R1 847 148) in the taxpayer’s taxable income and referred to it as the “inability agreement”.

In his judgement, Corbett CJ held that at the time when the “sale and manufacturing agreement” and the “inability agreement” were entered into, the business operations from which the taxpayer derived its income, were conducted predominantly outside South Africa. This aspect was regarded to be of fundamental importance. The entire foundation of the taxpayer’s business rested upon the rights that flowed from the registration of the patent, the trade mark rights and the contractual rights, all of which were acquired and exercised in West Germany. Accordingly, the originating cause of the receipt arising as a result of the “inability agreement”, and therefore its source, was not within South Africa.

Corbett CJ stressed that there may, in individual cases, be a number of causal factors and stated that in the circumstance of the case it was appropriate to determine the dominant or main or substantial or real and basic cause of the

receipt¹²⁶. He unfortunately did not mention the reasoning in his previous decision in the *Tuck* case relating to the apportionment of income into its contributing causal parts. Yet the words seem to allow, or at least do not exclude, the possibility of an apportionment of source in circumstances where this might be warranted.

He quoted the remarks of Isaacs J, delivering the judgment of the High Court in Australia in the case of *Nathan v Federal Commissioner of Taxes*¹²⁷:

“The Legislature in using the word ‘source’ meant, not a legal concept, but something which a practical man would regard as a real source of income . . . (T)he ascertainment of the actual source of a given income is a practical, hard matter of fact.”

Justice Corbett pointed out that in applying these general principles, the courts¹²⁸ have adopted certain rules and criteria for locating the source of particular types of accrual or receipt, such as dividends, annuities, director’s fees, interest, payment for services, rent, royalties, and so on. None of these would seem to have relevance to the somewhat unusual character of the “inability consideration” of *Essential Products*. Of fundamental importance in

¹²⁶ Extract from *Income Tax Cases and Materials* by Emslie, Davis, Hutton and Olivier, 2001.

¹²⁷ (1918), 25 CLR 183 at 189-90

¹²⁸ See *Liquidator, Rhodesia Metals Ltd v Commissioner of Taxes*, 1938 AD 282, 9 SATC 363, at 300; *CIR v Lever Brothers and Unilever Ltd*, 1946 AD 441, 14 SATC 1 at 454.

this case is that at the time when the “sale and manufacturing agreement” and the “inability agreement” were entered into, the business operations from which the taxpayer derived its income were conducted predominantly outside South Africa.

The question of apportionment, therefore, did not arise in this case since the manufacture of the active substance by the taxpayer – the only significant activity which took place in South Africa - was not a significant causal factor in relation to the inability consideration.

5.3.1. Application of the *Essential Sterolin Products* principle (source)

In *First National Bank of Southern Africa Ltd v C:SARS*¹²⁹ the court had to decide whether interest income accruing to the taxpayer from international financing transactions, was received “from a source within . . . the Republic” as contemplated in the definition of gross income in section 1. The taxpayer provided foreign currency to individual South African corporate clients as part of a loan facility agreed to in South Africa. The foreign currency was made available in New York and had to be repaid there.

The court held, applying the principles enunciated in *Essential Sterolin Products (Pty) Ltd v CIR*, that the source of the interest was located in South Africa and was correctly held by the court *a quo* to have been part of the taxpayer’s gross income and therefore subject to tax.

¹²⁹ 2002 (SCA), 64 SATC 245 at 252

The legal principles that hold sway in matters involving questions of source were articulated by Corbett CJ in *Essential Sterolin Products* and the principles and approach laid down in the case were not in any way at variance with the judgment of Watermeyer CJ in the *Lever Bros*¹³⁰ case. The court stressed that apart from the fact that contractually the foreign currency had been made available to the borrowing client in New York and had to be repaid there, all the other important factors which caused the interest income to arise (and which constituted the dominant cause of the receipt of the interest) had their origin in South Africa and flowed from the taxpayer's business activities and operations here. Moreover, the narrow view taken by the taxpayer focussed only on where the funds had been made available and had to be repaid and it overlooked the need to have regard to the essence of the whole transaction which generated the interest with a view to determining the location of its source.

In applying the principles set out in the *Lever Brothers'* case, the court ruled that although the basic calculations were made in foreign currency and then converted into South African rand, the debts in issue were incurred by the taxpayer's South African clients in South Africa and the interest was paid by them in rand after having been debited against their South African accounts and, as far as the add-on interest and forward cover premium to which the taxpayer was entitled in respect of each transaction was concerned, these were debited and paid in South African rand in South Africa and, accordingly, the source of the interest income derived by the taxpayer was in South Africa and not overseas.

¹³⁰ *CIR v Lever Brothers and Unilever Ltd*, 14 SATC 1

5.3.2 Conclusion on source of income:

With the advent of residence-based taxation in South Africa, the decision in the *Essential Sterolin Products* case has become of minor importance. However, in the applicable circumstances where the issue of source is under consideration, the source of the income should be established in accordance with the principles that were laid down in that case.

5.4 CONCLUSION

Justice Corbett's formative approach was evident in his minority judgement in *Elandsheuwel*. It favoured the taxpayer. Although his reasoning was legally sound, when it came to the control of the company he was on the side of the minority shareholders who did not have a history of dealing in land. It became apparent from the cases subsequent to *Elandsheuwel* in South Africa as well as cases in United Kingdom and New Zealand, that the intention of the company is determined by the controlling (majority) shareholders. Yet both the majority and minority judgements in *Elandsheuwel* had an unsatisfactory outcome. It was a case of all or nothing for the taxpayer. Today a more equitable result is possible: according to paragraph 12(2)(c) of the Eighth Schedule to the Act, the property should be valued at the time of the change of intention. A proper apportionment between capital and revenue profit is thus possible.

In the *Tuck* case, Justice Corbett found that two causally relevant elements were equally important regarding the lump sum received by the taxpayer. The element of service was plainly of a revenue nature, while the element of restraint was plainly of a capital nature. Therefore, in the absence of any other

acceptable basis of apportionment, an arbitrary 50:50 apportionment was considered to be fair and reasonable. The judgement of Justice Corbett on the receipts being capital or revenue in nature in the *Tuck* case flies in the face of previous judgements¹³¹, where the “all or nothing” approach was followed.

In *Essential Sterolin Products*, the business that was sold had its operations, from which it derived its income, predominantly outside South Africa. Justice Corbett concluded that the entire foundation of the taxpayer’s business depended on the rights that flowed from registration; the patent and trade mark rights; all of which were acquired and exercised in West Germany. Accordingly, the originating cause of the receipt of the consideration, and therefore the source thereof, was found not within South Africa.

In the *Essential Sterolin Products* case Justice Corbett laid down the principles of source if a South African taxpayer sells shares or commodities in a foreign entity to a foreign taxpayer. However, with the advent of residence-based taxation in South Africa, this decision has become less important.

¹³¹ Such as in *Pyott Ltd v CIR*, 1945 AD 128, where the full amount received was taxed, because there was no “halfway house” on receipts at that point in time.

CHAPTER 6 GENERAL DEDUCTIONS

6.1 INTRODUCTION

Justice Corbett was involved in several cases regarding expenses that taxpayers had claimed in terms of the general deduction formula. He made a major contribution to the interpretation of the general deduction formula and the search for “equity” in taxation with his involvement in six major landmark decisions¹³² in this regard.

Each of the six cases he was involved with, is analysed by comparing it to subsequent local cases in which the principles concerned, were applied. It is also compared to foreign cases in order to ascertain whether the principles were consistent with international practice.

¹³² The following cases are discussed in this chapter:

- *Nemojim* and *De Beers Holdings*. These cases concerned the deduction of opening stock, apportionment of expenses in dividend stripping and the taxpayer’s lack of a profit motive.
- *Standard Bank* and *Pick ‘n Pay*. In these cases expenses had to be apportioned between “use and non-use for trading purposes”.
- *Edgars Stores* and *Golden Dumps*. These cases concerned issues which were relevant to the incurral of expenses.

6.2 APPORTIONMENT OF EXPENSES

Section 23 (g) of the Act, until 1992, prohibited the deduction of “*any moneys claimed as a deduction from income derived from trade, which are not wholly or exclusively laid out or expended for the purposes of trade*”¹³³. The question that arose, is whether apportionment was allowable when a single lump-sum expenditure was laid out for more than one purpose.

6.2.1 Background

Many items of expenditure are incurred with mixed motives. A taxpayer who carries on more than one trade might incur lump-sum expenditure for the benefit of his various trades. Expenditure may be incurred partly for the purpose of earning ‘income’ as defined in section 1 and partly for the purpose of deriving income that is exempt from tax in terms of section 10 of the Act. It may also be incurred partly for the purpose of deriving income and partly for the purpose of acquiring a fixed capital asset for the business. In a Zimbabwean case¹³⁴, Beadle J said:

“It seems to me that where the operations of a taxpayer earning the non-taxable amounts are identical in character to those earning the ‘income’, and there are no extraordinary expenses which can be allocated either to non-taxable amounts or ‘income’, then if the

¹³³ The amended section 23(g) now reads as follows: “... any moneys, claimed as a deduction from income derived from trade, to the extent to which such moneys were not laid out or expended for the purposes of trade”.

¹³⁴ Local Investment Co v COT 1958 (3) SA 34 (SR), 22 SATC 4

proportion which the non-taxable amounts bear to the gross income is approximately the same as the proportion which the capital invested in the operations earning the non-taxable amounts bear to the total capital invested, this proportion is a fair basis for apportionment.”

These situations should be distinguished from the case where expenditure is incurred partly for the purpose of earning income and partly for private or domestic purposes or for purposes not connected in any way with the trade that the taxpayer carries on. In a situation of this nature it may be said that the expenditure was not wholly or exclusively incurred or expended for the purposes of trade and therefore no portion was deductible in terms of the previous version of section 23(g).¹³⁵

According to the Explanatory Memorandum on the Income Tax Bill of 1992 when section 23(g) was amended, it was stated:

“...it has been the long-standing practice of Inland Revenue [now SARS], which has in the past been accepted by the courts, to allow an apportionment of expenditure incurred partly for purposes of trade and partly for purposes other than trade.”

A share-dealing company is exempt from tax on almost all of its receipts and accruals of dividends, but expenditure that it incurs in carrying on its business of share dealing is allowed as a deduction in the determination of its taxable income. Such expenditure is allowable as having been incurred in the

¹³⁵ ITC 1385 (1984) 46 SATC 111 at 116

production of income which is not of a capital nature. The income is produced in the form of the proceeds that arise on the disposal of shares that constitute trading stock. The expenditure is usually not incurred in the production of the exempt dividend income and consequently not excluded as a deduction in terms of section 11(a) or section 23(f).

Dividend-stripping operations and schemes were able to profit from the distinction that the Act makes between, on the one hand, the dividends that a share-dealing company earns and which are usually exempt from tax, and, on the other hand, the proceeds of the shares that it holds as its trading stock, which constitutes gross income and from which the cost of the shares and all other associated costs may effectively be deducted. A typical scheme of this nature operated as follows. A dividend-stripping company would buy shares in another company as trading stock, usually a cash flush company. The buying company then caused the target company to declare and distribute a tax-free dividend out of its undistributed profits; and then sell the shares, depleted in value, at a 'loss'. The loss represented the difference between the cost of the shares and their selling price. The two advantages that were to be gained were, firstly, a loss that could be set off against other income and, secondly, the effective receipt, in the form of tax-free dividends, of what would otherwise be the taxable proceeds of the disposal of the shares.

The authorities did not display much enthusiasm for this form of tax avoidance. Their initial response was an attempt, as demonstrated in *Hicklin v*

*SIR*¹³⁶, to frustrate the objectives of the seller by means of section 103(1), which seeks to combat schemes for the avoidance of tax. This attempt failed.

An exception to the rule, that the expenditure that is incurred by a share-dealing company in carrying on its business is deductible in full, was provided by *CIR v Rand Selections Corporation Ltd*¹³⁷. The company involved in this case derived its income from, *inter alia*, share dealing and dividends. On 1 October 1948, it held shares in a company referred to as 'Lace'. On 18 December 1948, it bought a further large number of shares in the company, knowing that the company was to go into liquidation. The court had to decide what proportion of the total original cost of the shares could be deducted from the income of the company.

Centlivres CJ, who delivered the judgment of the majority of the Appellate Division of the Supreme Court, held that the company had incurred the full cost in the production of the total sum received during the year. However, a portion of the total receipts consisted of (tax-free) dividends; therefore a portion of the cost had to be regarded as having been incurred in the production of dividends and was therefore inadmissible as a deduction. He also held that the amount to be deducted in terms of section 11(a) could not be determined arbitrarily, as had been done by the Commissioner, but should be determined in the proportion to the "non dividend income" element of the total

¹³⁶ *Hicklin v SIR*, 1980 (1) SA 481, 41 SATC 179

¹³⁷ *CIR v Rand Selections Corporation Ltd*, 1956 (3) SA 124(A), 20 SATC 390

receipts produced by the expenditure. Corbett JA, in his judgement in *CIR v Nemojim (Pty) Ltd*¹³⁸, extended the principle to dividend stripping operations rather than just limiting the principle in the *Rand Selections* case (*supra*) to liquidation dividend schemes.

6.2.2 Apportionment in the case of dividend stripping

In delivering his judgement in the *Nemojim* case, Corbett JA noted that the appeal involved a financial operation known as “dividend stripping”. The taxpayer was a private company which purchased shares in another company amounting to R992 125.

He furthermore observed that it appeared that the accounting methods that were provided for by section 22, and which could be applied without difficulty in the case of normal trading operations, could not be applied without adaptation in exceptional cases. He regarded *Nemojim’s* trading operations as indeed representing an exceptional case. He took the closing stock value and therefore its costs, after its dividends had been “stripped” from the company to be R379 234.

Justice Corbett concluded his judgement as follows:

“I am of the opinion that the court a quo came to an incorrect conclusion in regard to the manner in which Nemojim should be taxed in regard to its dividend stripping operations. Contrary to the court a

¹³⁸ 1983 (4) SA 935(A), 45 SATC 241

quo, I hold that in a case such as this, expenditure incurred in the acquisition of shares relating to companies where dividend stripping occurred should be apportioned in accordance with a formula.”

The formula used by Justice Corbett followed the formula used in the *Guardian Assurance*¹³⁹ case, namely, to apportion the expense or purchase price of the shares to equal the cost of the shares after the dividend was declared. Therefore the purchase price allowed as a deductible expense for tax purposes would be the *ex-dividend* price. This formula effectively closed the loophole for dividend stripping operations.

6.2.3 Application of the apportionment principle developed in *Nemojim*

In *Tuck v CIR*¹⁴⁰, a case already discussed in paragraph 5.2 above and which dealt with apportionment in relation to a receipt into its capital and revenue components, apportionment was held to be appropriate. It was found in that case that a 50/50 apportionment would be fair and reasonable.

*Gerber v CIR*¹⁴¹ concerned a dividend-stripping scheme of which the facts were similar to that of the *Nemojim* case. By applying the principles that were derived from *Nemojim*, the court disallowed the expenses relating to the dividend in a dividend stripping scheme.

¹³⁹ *SIR v Guardian Assurance Holdings (SA) Ltd* 1976 (4) SA 522 (A), 38 SATC 111

¹⁴⁰ 1988 (3) SA 819 (A), 50 SATC 98 at 114 & 115.

¹⁴¹ 1989 (4) SA 855 (A), 51 SATC 183 at 187, 190, 192 and 194

In *Van Blommestein v KBI*¹⁴², the taxpayer claimed interest paid as a deduction. In terms of a will, the taxpayer's inheritance was subject to an obligation to pay the amount stipulated in a bequest to his two sisters and their children. These obligations were to be secured by mortgage bonds that were registered over the inherited farm. In terms of the will, the taxpayer was obliged to pay interest on the bonds to his two sisters. The court had to decide whether the taxpayer could deduct such interest in terms of section 11(a). It held that, in view of fact that the taxpayer had inherited both productive and non-productive assets and that the bond obligations related to both, the principle of apportionment, as applied in *Nemojim*, was to be applied. Accordingly, the court held that the taxpayer's interest expenditure was to be apportioned in the ratio of the value of the income-producing assets that he had inherited to the value of the inheritance as a whole. The income-producing assets amounted to 60% of the taxpayer's inheritance and therefore he was allowed to deduct 60% of the interest that he had paid.

6.2.4 Application of the general deduction formula¹⁴³ as applied in *Nemojim*

In delivering the judgment of the Court in *Commissioner of Inland Revenue v*

¹⁴² 59 SATC 221 at 226 & 235, 1997 (C)

¹⁴³ Schreiner JA said in *Commissioner for Inland Revenue v Genn & Co (Pty) Ltd*, 1955 (3) SA 293A at 299G: “In deciding how the expenditure should properly be regarded, the court clearly has to assess the closeness of the connection between the expenditure and the income earning operations, having regard both to the purpose of the expenditure and to what it actually affects.”

*Standard Bank of SA Ltd*¹⁴⁴, Corbett JA alluded to the importance of the purpose of the expenditure concerned and the closeness of its connection with the relevant income-earning operations (or exempt income received), when applying the general deduction formula (s 11(a)) and its negative counterparts (s 23(f) and(g)) of the Act. He mentioned *Nemojim* and cited extensively from the *Allied* case¹⁴⁵ in formulating the following principles:

- (1) The closeness of the connection between the expenditure and the income-earning operations should be assessed. The same general test applies to the provisions of section 23(f) of the Act.
- (2) More specifically, in determining whether interest (or other like expenditure) that is incurred by a taxpayer in respect of moneys borrowed for use in his business is deductible in terms of the general deduction formula and its negative counterparts in the Act, a distinction may in certain instances have to be drawn between two scenarios. The one scenario is a case in which the taxpayer borrows a specific sum of money and applies it for an identifiable purpose. The other scenario is a case in which, as in the *Allied Building Society* case, the taxpayer borrows money generally and upon a large scale in order to raise floating capital for use in his (or its) business as a banker.

The court found that the vital enquiry related to the Bank's purpose in borrowing the moneys upon which it paid interest. Then the court had to determine the closeness of the connection between the borrowings (and interest paid) and the acquisition of the redeemable preference shares (and

¹⁴⁴ 1985 (4) SA 485 (A), 47 SATC 179 at 194

¹⁴⁵ CIR v Allied Building Society, 1963 (4) SA 1 (A), 25 SATC 343,

dividends received). The court concluded that there was no sufficiently close connection between the Bank's payment of interest and its receipt of dividends on the redeemable preference shares. Thus the court concluded that the expenditure was not incurred in the production of exempt income, which would make it inadmissible for deduction under section 11(a). The interest expense was therefore allowed in full as it was not directly linked to the earning of the exempt dividend income.

In *Ticketin Timbers CC v CIR*¹⁴⁶, the court relied on Justice Corbett's *dictum* in *Nemojim* regarding the general deduction formula. The court had to decide whether interest that was incurred by a close corporation on capital that had been borrowed from its only member was deductible in terms of sections 11(a) and 23(g). It was held that the enquiry should proceed by examining, on the facts of each case, firstly, whether the expenditure in question could be classified as expenditure actually incurred in the production of income and, secondly, whether its deduction was prohibited by section 23(g), as was the case in *Nemojim*. It was found that the taxpayer had incurred the interest-bearing debt in order to make a distribution to its sole member, because without the loan there would have been no distribution and without the distribution there would have been no loan. Therefore the interest was not deductible in terms of section 11(a) as read in conjunction with section 23(g).

In *C:SARS v Van der Westhuizen*¹⁴⁷, the taxpayer and his brother each owned 50% of a company that carried on fishing and farming operations. The taxpayer purchased his brother's 50% interest by obtaining finance from the

¹⁴⁶ [1999] 4 All SA 192 (A), 61 SATC 399 at 401

¹⁴⁷ 2001 (C), 63 SATC 191 at 195-6,

company's bank. The taxpayer claimed that such interest expenditure had been incurred in the production of income. It was held, with reference to Justice Corbett's *dictum* regarding the general deduction formula in *Nemojim*, that the link between the expenditure incurred by the taxpayer to acquire his brother's member's interest and his income-producing activities were clearly shown in the evidence and was therefore deductible.

6.3 THE LACK OF A PROFIT MOTIVE

In *De Beers Holdings (Pty) Ltd v Commissioner for Inland Revenue*¹⁴⁸, Justice Corbett found it hard to believe that a taxpayer would enter into a transaction without the object of making a profit. In fact, the object of the transaction appeared to be to make a loss. The perception of Mr Justice Corbett's *pro-fiscus* approach has been based on his decision in this case¹⁴⁹.

The taxpayer company was a share dealer. In 1973, it acquired shares in a company called Engelhard Hanovia SA (Pty) Ltd ("Engelhard") with the intention of placing that company into voluntary liquidation. Due to changes in legislation, the taxpayer decided to implement a transaction in which it would sell its shares in Engelhard to an associated company for R1. It reflected the cost of the shares as trading stock, namely R4 159 937. In the 1979 tax year, it sought to deduct the loss on the sale of the Engelhard shares,

¹⁴⁸ 1986 (1) SA 8(A), 47 SATC 229

¹⁴⁹ An essay by D M Davis on "Substance over Form in Tax Law: The Contribution of Mr Justice Corbett" - *The Quest for Justice* at page 148.

that is, the difference between R4 159 937 and R1. The Commissioner disallowed this loss.

The Appellate Division raised the issue of section 23(g), which, at that time, prohibited the deduction of money “*not wholly and exclusively laid out or expended for the purpose of trade*”. Corbett JA, delivering the judgement of the court, decided that section 23(g) was the applicable section. He found that the taxpayer was a share dealer, but that the Engelhard shares had not been acquired for the purposes of its trade. Corbett JA reasoned as follows:

“I have already indicated that the absence of a profit does not necessarily exclude a transaction from being part of the taxpayer’s trade; ... A loss must, in order to satisfy section 23(g), be shown to have been so connected with the pursuit of the taxpayer’s trade, e.g. on the ground of commercial expediency or indirect facilitation of the trade, as to justify the conclusion that, despite the lack of profit motive, the moneys paid out under the transaction were wholly and exclusively expended for the purposes of trade.. . . Generally, unless the facts speak for themselves, this will call for an explanation from the taxpayer.”

In applying this test to the facts, Corbett JA held that the taxpayer had not entered into a normal share-dealing transaction. The scheme was not entered into to make a profit, but to register a loss and ultimately to obtain a substantial tax deduction. In short, Mr Justice Corbett extended the limitation of a tax deduction in terms of section 23(g) by equating trade with profit. In this manner he was able to examine the substance of the transaction, namely the exploitation of certain loopholes in the Act in order to construct a tax loss. In this case it was suggested that the Appellate Division had followed recent

jurisprudence in England where the courts favoured a substance-over-form approach. As one commentator argued "*...in order to achieve his disallowances... he has... had to ride roughshod over the trading stock provisions of the Act in order to achieve so-called equity*".¹⁵⁰

The definition of "trading stock" was amended after the *De Beers Holdings* decision to include "*any consumable stores and spare parts acquired... to be used or consumed in the course of his trade*". This was done, because it was clear, that, in the light of Corbett JA's comments, such items did not fall within the definition. Taxpayers thereafter did not add back the value of their consumable stock on hand at the end of their year of assessment to taxable income, based on the definition of trading stock in *De Beers*. This caused a loss to the *fiscus* and, as has been indicated above, the definition of trading stock in section 1 of the Income Tax Act was subsequently amended to include consumables as stock in terms of section 22 of the Act.

6.3.1 References to "profit motive" as discussed in the *De Beers Holdings* judgement

The judgement in the *De Beers* case has been referred to on several occasions regarding the issue of the "profit motive":

¹⁵⁰ "The Appellate Division and Equity in Taxation" an essay by T Emslie in the Income Tax Reporter, No. 26 (1987) at p51.

In *CIR v Pick 'n Pay Employee Share Purchase Trust*¹⁵¹, the Trust contended that the proceeds from its disposal of the shares in question constituted amounts of a capital nature that are excluded from 'gross income' as defined in section one of the Act. Furthermore, the representatives of the Trust contended that it was created and maintained to enable employees to purchase shares in their employer company and that it did not acquire shares with the intention of reselling them at a profit in a profit-making scheme. The Trust was continuously engaged in share-dealing during the years of assessment concerned.

It was held that, irrespective of the number of transactions that occurred, the receipts that flowed from the carrying on of a business were to be considered to be revenue if the business were conducted with a profit motive, that is, as part of a profit-making venture or scheme. To hold otherwise would amount to a departure from earlier authoritative judgements. The normal way in which a share trader operates, is to buy shares and then to resell them at a profit (cited *De Beers Holdings*). The Trust had no such intention. While a profit motive is not essential for the carrying on of a business, its presence or absence is an important factor in determining whether a business is being conducted.

Justice Smalberger said:

“Whether the Trust was carrying on a business by trading in shares must be determined applying ordinary common sense and business standards. Even if the Trust could be said in a broad sense to have

¹⁵¹ 1992 (A), 54 SATC 271 at 280

been conducting a business, it was not a business carried on as part of a scheme of profit-making. Receipts of a revenue nature (in the form of profits) accrue to a trader who acquires and disposes of shares as part of a scheme of profit-making (per De Beers Holdings). The purpose of the scheme was not one of profit-making. A dealer doing business in shares can be expected to engage freely in the market; to buy and sell at the most advantageous times and prices according to the dictates of the market. This is not what the Trust did. It bought when it was obliged to and sold when it was required to.”

It was accordingly held, in a split decision (3:2), that any receipts accruing to the Trust from the sale of shares were not intended or aimed at making a profit, but were purely fortuitous in the sense of being an incidental by-product. The receipts were therefore non-revenue because they were accruals of a capital nature that fell beyond the definition of gross income and for that reason they were not subject to tax.

Profit-making schemes create revenue income. Justice Corbett wanted to extend this principle to deductions, namely to allow deductions in a profit making scheme, but disallow deductions if there is no profit making motive, such as in the *De Beers* case. In the *Pick n Pay Employee Trust* case, the court applied this principle from the *De Beers* case on the income of the trust. However, this profit motive principle is not applicable on the expenditure side. There are various reasons why a transaction has no profit motive - being obliged to buy and sell shares, such as in the circumstances of the *Pick n Pay Employee Trust* case. Other examples of deductible expenses or losses include selling at a loss for competition purposes, clearing out old stock, improving market share, even shares can be sold at a loss for various reasons. However,

stripping shares of its value by paying out dividends is not allowed as a deduction¹⁵².

In *CIR v Sunnyside Centre (Pty) Ltd*¹⁵³, the taxpayer deducted interest on loan transactions in terms of sections 11(a) and 23(g) of the Act. The taxpayer had borrowed interest-bearing money from a bank and applied part of the funds to repay its indebtedness to a holding company and lent the balance at interest to the holding company. The purpose and effect of the loan that the taxpayer received was to repay its interest-bearing debt to the holding company and to lend the balance to it with interest.

It was held that the transaction at issue was not connected with the taxpayer's trade and that it had a purpose other than that of deriving income. Therefore, in accordance with *De Beers Holdings*, in the absence of an explanation or of facts that speak for themselves in a manner that is favourable to the taxpayer, the moneys were not expended for the purposes of trade.

In ITC 1292¹⁵⁴, the taxpayer had claimed to deduct losses incurred by him in carrying on the trade of letting a house. The Secretary disallowed the deductions claimed and dismissed the subsequent objection. The Special Court established that the house in issue was at the seaside and had been built by the taxpayer as a vacation residence. Thereafter, when not occupying the house

¹⁵² The perceived tax advantages of dividend stripping were not permitted in *CIR v Nemojim (Pty) Ltd*, 45 SATC 241

¹⁵³ 58 SATC 319 at 325-6

¹⁵⁴ (1979) 41 SATC 163

himself, he occasionally let it to private individuals. He later concluded a contract with his employers where, for an annual rental, members of their staff used the house when he himself was not using it.

The Special Court found that the taxpayer's real object was to minimize the cost of having a vacation residence and that there was no prospect of him making any profit at all by letting the house. A prerequisite of deductibility of expenditure is that there must be a real hope, based not on fanciful expectations, but on a reasonable possibility of earning a profit. Since in the circumstances no such real hope existed, no portion of the losses was deductible.

However, in a similar situation in 1997, in Special Board Decision No 79, the taxpayer appealed against the disallowance of his objections to his Income Tax assessments for the tax years 1990, 1991 and 1992. The objections were in each case to the refusal of the Commissioner for Inland Revenue to allow as deductions from the taxpayer's gross income a net loss arising out of expenses incurred by the taxpayer relating to a certain residential property owned by the taxpayer. The net loss arose in each of the 3 tax years after setting off, against the expenses, the rental income which accrued to the taxpayer from the letting of the property. The amounts of the expenses were not in dispute.

The taxpayer stated that he changed his intention regarding the property from a holiday home to a business proposition due to the following facts –

1. After the divorce his decision to retain the property was influenced because he regarded the property as an investment in a growth area particularly as a vacation point.
2. He needed an investment with capital growth because at the time he was employed by a small company which did not have a pension fund. He had subscribed to a Retirement Annuity Policy but did not regard it as adequate. He felt he would be destitute on retirement if he did not have an asset to sell to supplement his pension.

The Board accepted the taxpayer's evidence. Citing the *De Beers* case, the Board found that the necessity for the achievement of a profit for the conduct of a trade, "if not dead, has certainly been dealt telling blows". The court concluded that the taxpayer embarked on the trade of letting the property, as he had no need for a holiday home after his divorce. The appeal was upheld as the profitability of the investment had no bearing on the deductibility of the losses.

6.3.2 Application of the definition of stock in *De Beers Holdings*

Before *De Beers* there had been no previous court case in South Africa regarding the treatment of stock for tax purposes. Justice Corbett was obliged to consider the accounting treatment of stock in AC106, the South African General Accounting and Auditing Practice principle dealing with the treatment of stock, and also the definitions that appeared in the Oxford English Dictionary. Very little could be gained from the judgements in cases that had been heard in other countries.

Corbett JA analysed the definitions and concluded that:

“The definition falls naturally into two parts per section 1:

(1) anything produced, manufactured, purchased or in any other manner acquired by a taxpayer for purposes of manufacture, sale or exchange by him or on his behalf, or

(2) anything where the proceeds from the disposal will form part of his gross income.

To stretch the definition to cover things acquired without the intention to sell would introduce a hypothesis which would not come to pass and to do so would do violence to the plain words used.”

In *Richards Bay Iron & Titanium (Pty) Ltd and Another v CIR*¹⁵⁵, Marais JA followed the definition of stock by Justice Corbett in *De Beers*.

In *Syfrets Participation Bond Managers Ltd v C:SARS*¹⁵⁶, the taxpayer had made investments in participation mortgage bonds. According to the taxpayer, it constituted “trading stock” for the purposes of section 11(a). The court had to decide whether, if section 22(1) were applicable, the value of the trading stock, that is, the participation mortgage bonds had, for the purposes of that provision, diminished below its cost, thereby entitling the taxpayer to the appropriate deductions.

It was held that the taxpayer’s own participation mortgage bonds did not fall within the first or the second part of the definition of ‘trading stock’ in section 1 of the Act as the taxpayer failed to show that the participation bonds

¹⁵⁵ 58 SATC 55 at 68, 1996 (1) SA 311 (A)

¹⁵⁶ 63 SATC 1 at 6-7, 2000 (SCA)

were going to be sold or exchanged. Furthermore, even if it did fall within the definition, and contrary to what was said in *De Beers Holdings*, the definition of stock was not exhaustive and the participation bonds which the taxpayer held could not be regarded as stock. The court pointed out that the appellant was not “trafficking” in participations, it was not “purchasing and selling” participations in order to generate an income from such activity; its own involvement in participations was temporary and incidental to its true vocation which was to administer the scheme in return for its agreed commission and, as such, its “holding” of participations was *prima facie* of a capital and not of a revenue nature.

6.3.3 Conclusion on *De Beers Holdings*

The *De Beers* case is an example of a case in which Mr Justice Corbett supposedly adopted a *pro-fiscus* approach. An analysis of that judgement reveals that the court applied some of the provisions of section 23(g) to disallow a substantial deduction, which had clearly been the major objective of the transaction. The only possible criticism of the judgement could be that the court equated the word “trade” with “profit” so that the lack of a profit motive meant that the taxpayer was not trading and therefore could not claim a deduction. In isolation, this approach to the section concerned can hardly be equated with the purposive approach to the interpretation of tax legislation that has been adopted in certain English cases.

According to Professor Davis¹⁵⁷, Justice Corbett extended the limitation of a tax deduction, in terms of section 23(g), by equating trade with profit. In this manner Justice Corbett was able to examine the substance of the transaction that comprised the exploitation of certain loopholes in the Act in order to construct a tax loss. It has been suggested that in this case the Appellate Division followed the jurisprudence that was applied in England, where the courts favoured a substance-over-form approach. Justice Corbett showed that he was not inflexible in his approach to a tax problem. He was able to change from a normally formative approach to a substantive approach in, what he considered, the appropriate circumstances.

6.4 THE CLOSE CONNECTION BETWEEN EXPENSES INCURRED AND RELEVANT INCOME-EARNING ACTIVITIES (THE PRODUCTION OF INCOME).

In *Commissioner for Inland Revenue v Standard Bank of SA Limited*¹⁵⁸, the Bank claimed deductions for three years of assessment in respect of interest paid on money borrowed. The Commissioner for Inland Revenue disallowed a portion of each of these deductions. The Bank received income in the form of dividends. These dividends were exempt and not taxable in the hands of the Bank (by virtue of section 10(1)(k) of the Act). The Commissioner contended

¹⁵⁷ An essay by D M Davis on “Substance over Form in Tax Law: The Contribution of Mr Justice Corbett” - *The Quest for Justice* at page 151.

¹⁵⁸ 1985 (4) SA 485(A), 47 SATC 179

that a proportionate amount of the interest paid to depositors on the deposited money should be disallowed as a deduction, as it related to expenses which produced exempt income. The Bank disputed the validity of this contention.

In delivering the judgment of the court, Corbett JA referred to *Nemojim* (*supra*) and alluded to the importance of the purpose of the expenditure concerned and the closeness of its connection with the relevant income-earning operations (or exempt income received) when applying the general deduction formula (section 11(a)) and its negative counterparts (section 23(f) and (g)) of the Act. After citing extensively from the *Allied Building Society* case¹⁵⁹, he concluded that:

- (a) All money borrowed goes into a common pool, which constitutes a fund that is used for all purposes.
- (b) Generally the institution's expenditure in the form of interest on borrowed money is not aimed at any particular form of utilisation of the borrowed money. Rather, it is dictated by the very nature of the institution's income-earning operations of borrowing all money offered cheaply and then lending out dearly as much thereof as it can possibly invest.

The court held that the immediate purpose of the Bank in borrowing money is to obtain the floating capital with which to run its business. The cumulative effect of the factors that had been indicated, as well as the insignificance of the amount of dividends against the total receipts, established that there was not a

¹⁵⁹ 1963 (4) SA 1 (A), 25 SATC 343 at 357

sufficiently close connection between the Bank's payment of interest and its receipt of dividends on the redeemable preference shares to warrant the conclusion that such payment (or part thereof) constituted expenditure that had been incurred in the production of exempt income. The appeal was accordingly dismissed.

This case was used by financial institutions to structure deals with clients whereby, instead of lending money to the client when the client was in an assessed loss situation, the financial institution rather invested in the company through redeemable preference shares. The tax efficiency of such convertible loans have been limited by the introduction of the anti tax-avoidance section 103(5) which deems the interest received on such preference shares to have accrued to the moneylender.

6.4.1 Application of the close connection between expenses incurred and related income-earning activities as applied in the Standard Bank case

In ITC 1603¹⁶⁰, a partnership embarked on a scheme in terms of which it repaid the taxpayer his portion of his capital account, which he then used to pay the balance of the bond on his property. Pursuant thereto, another loan was advanced by the bank under the same bond. The loan was paid to the partnership and credited to the taxpayer's capital account. The court had to decide whether the interest paid on the loan was deductible by the taxpayer in terms of section 11(a) read together with section 23(g).

¹⁶⁰ 58 SATC 212 at 215-6

The court held that the taxpayer was entitled to the deduction of the interest expense that he had incurred on the mortgage bond over his home in terms of section 11(a). Although an essential motive of the taxpayer, in undertaking the scheme, was to gain a tax advantage, the real issue was whether the expense had been incurred in the production of income.

In determining the answer to the question regarding the closeness of the relationship between expenses and income-earning activities, the court followed Justice Corbett's test in *Standard Bank*¹⁶¹, a test which is now well-established:

“... (I)t is settled law that generally, in order to determine in a particular case whether moneys outlaid by the taxpayer constitute “expenditure incurred in the production of the income”, important factors are the purpose of the expenditure and what the expenditure actually effects. And in this connection the court has to assess the closeness of the connection between the expenditure and the income-earning operations (see Nemojim).”

In *CIR v Ticktin Timbers*¹⁶², the sole member of the taxpayer close corporation charged interest in respect of its continued use of money owed to it. The court held that the transactions in issue were devised to ensure that the taxpayer helped to pay the interest which the sole member owed to the trusts, the intention being to increase the sole member's income and not that of the taxpayer. Therefore, the loans were created where none were needed for the

¹⁶¹ 47 SATC 170 at 152

¹⁶² 1997 (C), 59 SATC 260 at 263

taxpayer's income-producing activities. Accordingly, the interest at issue had not been incurred in the production of income and was not deductible in terms of section 11(a). Based on the principle in *Standard Bank of South Africa Ltd*, the question to be asked is: What is the purpose for which the money was borrowed? The answer is that the taxpayer's purpose was to discharge the distribution debt. The answer makes it clear that the issue does not concern expenditure incurred in the production of income.

6.5 WHEN IS APPORTIONMENT APPROPRIATE?

*CIR v Pick 'n Pay Wholesalers*¹⁶³ is a celebrated case¹⁶⁴ that involved large donations to the Urban Foundation, an organisation that was concerned with the upgrading of housing and the provision of community facilities. The company argued that the donations were a means of "indirect advertising" and were intended to secure valuable publicity. The announcement of the donations achieved sufficient publicity to have a positive effect on the taxpayer's turnover. At that time, section 23(g) required that expenditure to be deductible had to be wholly or exclusively laid out for the purposes of trade, as was decided in the *Solaglass* case¹⁶⁵. It raised the issue of whether the taxpayer's purpose was solely to promote its business or whether it had a dual nature, including philanthropy.

¹⁶³ 1987 (3) SA 453(A), 49 SATC 132

¹⁶⁴ Silke on South African Income Tax at § 7.3

¹⁶⁵ *Solaglass Finance Company (Pty) Ltd v CIR*, 1991, (2) SA 257 (A), 53 SATC 1.

The majority of the Appellate Division of the Supreme Court found that, on the balance of probabilities, the taxpayer failed to show that, in making the donations, it did not have both a philanthropic and a business purpose. The result was that its claim for a deduction was disallowed. The minority of the presiding judges considered that its sole aim was to acquire indirect advertising and that “*the expenditure was entirely divorced from the element of charity for charity’s sake*”.

In the case of *Bourne and Hollingsworth Ltd v Ogden*¹⁶⁶, the High Court refused a deduction for certain subscriptions that the company had made to the nearby Middlesex Hospital. The Inspector had allowed previous subscriptions, but the dispute in this instance concerned an abnormally large payment. Rowlatt J articulated the element of munificence or beneficence, which is often present in charitable giving and which can be a purpose that is additional to any business purpose. It appears that the less “selfish” the expenditure, the greater the likelihood of a non-business (and therefore a non-allowable) purpose.

Ironically, the dissenting judgement of Nestadt JA in the *Pick ‘n Pay* case, was based on the same grounds as the dissenting judgement of Corbett JA in the *Elandsheuwel* case – that the company is separate from its shareholders and that their intentions may be different¹⁶⁷. Nestadt JA said:

¹⁶⁶ *Bourne and Hollingsworth Ltd v Ogden*, [1929] 13 TC 349

¹⁶⁷ See paragraph 5.1.2

“As Centlivres CJ said in CIR v Richmond Estates(Pty) Ltd 1956(1) SA 602(A) at 606G: ‘A company is an artificial person with no body to kick and no soul to damn and the only way of ascertaining its intention is to find out what its directors acting as such intended’.”

Justice Nestadt concluded that, in the circumstances under consideration, care should be taken not to merge Mr Ackerman’s activities and intentions in his capacity as a director of the Urban Foundation and those in conducting the affairs of the taxpayer, where Mr Ackerman was then the managing director (see the minority judgment of Corbett JA in *Elandsheuwel Farming*):

*“Prima facie, the payment was therefore made with a charitable purpose and the taxpayer’s evidence confirmed that this was at least partly the purpose thereof. Accordingly, the taxpayer did not show that it was “wholly or exclusively laid out for the purposes of trade” merely by showing that it also had a business objective and that the donation resulted in a business advantage. The taxpayer’s purposes and motivations coincided and the two cannot be distinguished in this case.”*¹⁶⁸

Despite Justice Nestadt’s disagreement over the stance taken by Justice Corbett in his majority judgement, the position taken by Justice Corbett was not an about turn from his minority judgement in the *Elandsheuwel* case. Consideration was given to the fact that the same individual was involved in both organisations. It could also not be substantively proven that there was a

¹⁶⁸ See eg *Boarland v Kramat Pulai Ltd* [1953] 2 All ER 1122(Ch) at 1129D-F; *Nemojim’s case*(supra) at 947H-948C;65 and *De Beers Holdings(Pty) Ltd v Commissioner for Inland Revenue* 1986(1) SA 8(A), 46 SATC 47 at 36I-37B.66

direct link between the advertising expenses and the related income. Therefore the expense was considered to be (partly) philanthropic. It is submitted that, in this judgement, Justice Corbett distanced himself from his usual formative approach and followed the substance-over-form route. This change in approach caused his judgement to appear *pro-fiscus*.

The duality rule¹⁶⁹, as used in the United Kingdom tax law, prevents the deduction of expenditure for mixed purposes. This rule was incorporated by Justice Corbett into South African tax law in the *Pick n Pay* case. However, the rule does not prevent the apportionment of expenditure and the subsequent deduction of that portion of the expenditure that was incurred wholly and exclusively for business purposes.

It is settled law in both United Kingdom and South Africa that, when expenditure is incurred for dual purposes in which one of the purposes is not a trading purpose and the expenditure on trade cannot be separated and identified, then no portion of the expenditure is deductible¹⁷⁰.

Expenditure in the form of subscriptions to charitable organisations is the generous act of good citizens. There is, therefore, a duality of the capacity in

¹⁶⁹ From Butterworths' British Tax Law – The duality rule at page 216

¹⁷⁰ *Odhams Press v Cook* [1940] 3 All ER 15(HL); *Ransom v Higgs* [1973] 2 All ER 657(CA); *Ransom v Higgs* [1974] 3 All ER 949(HL); Also see ITC 698 17 SATC 97; ITC 734 18 SATC 202; ITC 847 22 SATC 77; *Odhams Press v Cook* [1940] 3 All ER 15(HL) at 20; *Ransom v Higgs* [1973] 2 All ER 657(CA) at 690E-692G and 699B-D; *Ransom v Higgs* [1974] 3 All ER 949(HL) at 958E-959A, 962E-963A, 968H-969E

which such payments are made, namely, partly as trader and partly as citizen.¹⁷¹ However, whether the explanation for the rejection of claims for the deduction of subscriptions is remoteness or duality, the deduction of such payments is rarely allowed. For example, subscriptions in the form of charitable donations to a hospital are not deductible.¹⁷²

The changes to section 23(g) in the Act, to allow apportionment, came into effect after the *Pick n Pay* case. If the legislative changes had taken place prior to the *Pick n Pay* case, the judgement may have been entirely different. However, Justice Corbett was rightly or wrongly applying the duality rule in disallowing this expense. It is submitted that apportionment should have been allowed as it was proved that some publicity was received by the taxpayer. All that was necessary was some basis to apportion.

6.5.1 CONCLUSIONS

6.5.1.1 Conclusion regarding apportionment

Justice Corbett was criticised for apportioning expenses in the *Nemojim* and *De Beers Holdings* cases and for not apportioning expenses in the *Pick n Pay Wholesalers* case. In all three cases the taxpayers came off second best. Judge Corbett did not apportion expenses in the *Standard Bank* case and found in favour of the taxpayer, a decision which benefited the taxpayer.

¹⁷¹ *Bentleys, Stokes and Lowless v Beeson (Inspector of Taxes)* [1952] 2 All ER 82

¹⁷² *Bourne and Hollingsworth Ltd v Ogden (Inspector of Taxes)* [1929] 14 TC 349

The *Pick 'n Pay* case was probably the most celebrated of the four cases decided by Justice Corbett regarding the apportionment of expenses. It was a 50/50 tussle between the taxpayer and the Commissioner. Justice Corbett sided with the duality rule¹⁷³ and could not distinguish a point at which the advertising began and the donation ended. His decision might have been influenced by the fact that the Urban Foundation received donations that were mainly of a philanthropic nature and businesses did not as a general rule, use the Foundation as an advertising vehicle.

It is submitted that probably in the *Pick n Pay* case, counsel for the taxpayer did not indicate a convincing way to apportion the expenses. Justice Corbett, to justify apportionment, needed some convincing in this respect. It should be noted, however, that an arbitrary apportionment appeared to be permissible as had the 50:50 apportionment in the *Tuck* case¹⁷⁴. The taxpayer submitted details of increased sales to prove the validity of the advertising expense. It is probable, however, that with the subsequent changes to section 23(g) that the court would have decided to apportion on some basis.

6.5.1.2 Profitability and the deductibility of losses

According to Silke¹⁷⁵, it is not a requirement of the general deduction formula that the taxpayer should set out to achieve a “profit” in an accounting or

¹⁷³ CIR v Pick n Pay Wholesalers, 49 SATC 132 on p 148

¹⁷⁴ see paragraph 6.2

¹⁷⁵ At § 7.11

economic sense. However, the absence of a profit motive or of the prospect of making a profit, together with other factors, might indicate that the taxpayer did not incur a particular expense in the production of income, or wholly or exclusively for the purposes of trade.

Corbett JA, as he then was, clearly highlighted the lack of a profit motive when he delivered the judgment of the Appellate Division of the Supreme Court in *De Beers Holdings (Pty) Ltd v CIR*, namely:

“Where, however, a trader normally carries on business by buying goods and selling them at a profit, then as a general rule a transaction entered into with the purpose of not making a profit, or in fact registering a loss, must, in order to satisfy section 23(g), be shown to have been so connected with the pursuit of the taxpayer’s trade, for example, on ground of commercial expediency or indirect facilitation of the trade, as to justify the conclusion that, despite the lack of a profit motive, the moneys paid out under the transaction were wholly and exclusively expended for the purposes of trade Generally, unless the facts speak for themselves, this will call for an explanation from the taxpayer.”

The first major case in which Mr Justice Corbett supposedly adopted a *pro-fiscus* approach was the *De Beers Holdings* case and thereafter followed by the *Pick n Pay* case. In both cases Justice Corbett interpreted the provisions of section 23(g) in order to disallow substantial deductions. The only possible criticism of the judgement in the *De Beers* case could be that Justice Corbett equated the word “trade” with “profit” so that failing to demonstrate a profit motive meant that the taxpayer was not trading and hence he could not claim a deduction. Considered in isolation, this approach to the section can hardly be

equated with the purposive approach to the interpretation of tax legislation that was adopted in certain English cases¹⁷⁶.

In order not to dilute the tax base, it is important for the *fiscus* to disallow non-trading deductions. Thus section 23 is there to protect the *fiscus*. Justice Corbett battled with the phenomenon in which a business willingly operates at a loss. A situation could arise in which the loss was not real, only a book entry, as was the case with *De Beers* and *Nemojim*.

6.6 INCURREAL OF COSTS

Normally an incurral is a simple matter: If goods or services are delivered and an invoice is received that states the amount owing, then the cost of the goods may be incurred, although it has not yet been paid for. Incurral is primarily applicable to cases in which full delivery has not yet taken place and/or when no invoice is available from the third party involved. It then becomes a question of law: When does the incurral of the legal obligation or liability take place? Justice Corbett battled with this issue in the two cases discussed in the following section, namely *Edgars Stores* and *Golden Dumps*.

6.6.1 Expense determined after the year end

In *Edgars Stores Ltd v Commissioner for Inland Revenue*¹⁷⁷, the taxpayer's retail clothing business was conducted in leased premises throughout southern

¹⁷⁶ See discussion in paragraph 3.3

¹⁷⁷ 1988 (3) SA 876(A), 50 SATC 81

Africa. Annual leases provided for a 'basic rental' and a 'turnover rental'. The taxpayer claimed deductions in terms of section 11(a) of the Act for rent, which represented genuine estimates (the final figures were not yet available) of the amounts by which the turnover rental exceeded the basic rental in the years of assessment concerned. The Commissioner disallowed the deduction. Corbett JA (with Hoexter JA, Vivier JA and Viljoen AJA concurring) held that the obligation to pay turnover rental was contingent upon the turnover for the lease year being determined.

In a dissenting judgement, Nicholas AJA held that the lease created a single obligation to pay rent, which comprised two components, namely basic rental and the excess, if any, of turnover rental over basic rental. Nicholas AJA also said that the lease therefore provided for one single obligation to pay rent and that, properly interpreted, the lease agreement did not provide for the substitution of basic rental by turnover rental. It did not matter that the actual amount could not be established with 100% accuracy. In spite of this powerful minority judgement, the majority decision was that it was not possible to determine the actual amount owed until the lease year had expired. The appeal was therefore dismissed with costs.

This was an unfortunate decision against the taxpayer and could also indicate a *pro-fiscus* approach by Corbett JA. Although it was impossible to calculate the exact amount owed at the year-end date, such a calculation is possible within a reasonable time frame after the year-end. The cost was in actual fact incurred during the period of the rental and not afterwards, as was pointed out in the minority judgement. If it is not possible for the taxpayer to calculate the turnover within the time limits before submission is due, then a reasonable

estimate can be calculated and should be allowed by the Commissioner. Should this estimate differ from the actual amount then a correction is possible by revising that year's assessment in accordance with section 79.

6.6.2 Application of the *Edgars Stores* principle on incurral

A bank that paid interest on Negotiable Certificates of Deposit, which it had issued, claimed that it was entitled to make certain deductions in the year of assessment concerned, in ITC 1485¹⁷⁸. The bank claimed that, in terms of section 11(a), it was entitled to deduct all the interest reflected on the Negotiable Certificates of Deposit that it had issued in that year of assessment, even though the greater proportion of the said interest was reflected as being payable in instalments on specified dates in future years of assessment.

The court held that the actual liability to pay interest was only incurred as and when the interest accrued on the outstanding loan. It was incurred and it accrued from day to day. Interest payable in future years of assessment was therefore not 'expenditure actually incurred' during the year of assessment in which the instrument was issued.

The court relied on the legal principles that had emanated from the cases of:

*Caltex Oil*¹⁷⁹, *Nasionale Pers*¹⁸⁰ and *Edgars Stores*:¹⁸¹

¹⁷⁸ 1990 (T), 52 SATC 337 at 341-2

¹⁷⁹ *Caltex Oil(SA) Ltd v Secretary for Inland Revenue*, 1975(1) SA 665(A) at 674: An obligation must be incurred unconditionally before it is allowed as a deduction in the year of assessment.

The principles to be applied in considering whether expenditure is deductible in a particular year of assessment are therefore well established. The court, however, imported from English law the principle that interest is incurred on a day-to-day basis, which is, it is submitted, not always true – it depends on how the capital is invested and the terms and conditions of the contract.

In ITC 1496¹⁸², which case involved a plantation-scheme, the taxpayer made an investment in a plantation venture by joining a partnership to carry on the business of timber plantation farming. The taxpayer paid a contribution to join the partnership. The taxpayer also provided finance by issuing a promissory note to the partnership. The promissory note included a capital amount as well as interest that accrued thereon. The taxpayer claimed a deduction equalling the full amount of the promissory note, in terms of section 11(a), read with section 23(g) in his income tax return for the year of assessment concerned. This amount comprised interest for five years as well as the actual plantation establishment and maintenance costs.

¹⁸⁰ *Nasionale Pers Bpk v Kommissaris van Binnelandse Inkomste*, 1986(3) SA 549(A) at 564: When an obligation is initially incurred as a conditional obligation during a particular year of assessment and the condition is fulfilled only in the following year of assessment, then it is deductible only in the latter year of assessment.

¹⁸¹ The deduction is only allowable if the conditional requirements of deductibility have been satisfied.

¹⁸² (1990), 53 SATC 229 (T) at 238

The court held that, although the promissory note could be considered to be evidence of a contractual liability to pay interest at some future date, the actual liability to pay only incurred as and when the interest became due on the outstanding loan, which is on a day to day basis. This decision was based on English law – it was not South African law at that time. This judgement was given by Melamet J, who also gave the judgement in ITC 1485 and, in regard to the incurral of interest, was, it is submitted, probably incorrect.

Reliance was placed on the *Edgars Stores* principle that when an obligation is initially incurred as a conditional obligation during a particular year of assessment and the condition is fulfilled only in the following year of assessment, then it is deductible only in the latter year of assessment. Section 24J was thereafter introduced and it now regulates the accrual and incurral of interest.

6.6.3 Expense to be determined by a court after the year-end

For accounting purposes, a pending court case for a damages claim can be either a contingency or an accrual, depending on the circumstances. The application of General Accepted Accounting Practice will determine whether the damages claim is either a contingent claim or an accrual of an expense.

For tax purposes, the question arises as to when the liability for damages is incurred - at the time the claim for damages is made or when the amount of the claim is finally determined by a court or even some intermediate time.

In *Commissioner for Inland Revenue v Golden Dumps (Pty) Ltd*¹⁸³, the facts were briefly as follows: The taxpayer's sole shareholder handed Mr Nash a letter of appointment that had been written on the taxpayer's letterhead. In the letter he offered Nash the position of financial director in his group with a commencing salary and an entitlement to 200 000 shares in a new company. Two months later Nash was summarily dismissed.

Thereafter, the attorneys acting for Nash wrote to the taxpayer to demand delivery of the shares that had been referred to in the letter of appointment and stated that failing delivery thereof, legal proceedings to compel such transfer would be instituted. The attorneys acting for the taxpayer denied liability and refused to accede to Nash's demand. In 1981 Nash proceeded to institute legal proceedings.

An appeal by Nash to the Appellate Division was upheld in 1985. The order of the court *a quo* was altered to read that the taxpayer was ordered to deliver to Nash 200 000 shares in Consolidated Modderfontein Mines Ltd against payment by him of the sum of R 88 250 to the taxpayer. The judgment, which was written by Corbett JA, was reported as *Nash v Golden Dumps (Pty) Ltd* 1985(3) SA 1(A). In the Special Tax Court, the parties accepted as correct the findings of the facts that were contained in the judgment.

In support of its return of income for the 1985 year of assessment, the taxpayer attached its annual financial statements, which reflected the amount owed to Nash for the 200 000 shares under the heading 'Extraordinary items'. The

¹⁸³ 1993 (A), 55 SATC 198

Commissioner for Inland Revenue disallowed the deduction on the grounds that the expense did not accrue in 1985. The taxpayer lodged an objection and noted an appeal against the assessment.

In dismissing the appeal and upholding the taxpayer's contention, Corbett JA held that:

- (i) A liability is contingent in a case in which a claim is disputed genuinely and not vexatiously or frivolously for the purposes of delay. In such a case, the ultimate outcome of the situation will be confirmed only if the claim is admitted or if it is finally upheld by the decision of a court or an arbitrator.
- (ii) When, at the end of the tax year in which a deduction is claimed, the outcome of the dispute is undetermined, it cannot be said that a liability has actually been incurred.

It should be pointed out that if the Commissioner had won the case, then the section 79 three year prescription rule would have precluded the taxpayer from claiming the expense. This fact, however, did not sway the decision by the courts and this decision is still applicable today.

6.6.4 Conclusion on incurrals

In both *Edgars Stores* and *Golden Dumps* the question of when an incurral of an expense arises, was addressed. According to Generally Accepted Accounting Practice as well as the provisions of section 11(a), expenditure can

be incurred or accrued although it has not yet been paid. This is the practice in many countries, including the United Kingdom and Australia.

If, however, the outcome of a dispute or court case is not finalised during the course of a financial year, then it is a contingent liability for accounting purposes for that year and it is not deductible for tax purposes as no liability has been established.

To meet the requirements of “actually incurred” and “during the year of assessment”, a deduction should be finalised in that fiscal year. This situation also prevails in the United Kingdom. In *Herbert Smith v Honour*¹⁸⁴, the rentals were fixed in a lease contract and the amount payable had therefore been established. If the *quantum* cannot be established then an extension for the submission of the return can be granted by the Commissioner, alternatively a reasonable estimate can be provided to the Commissioner in terms of section 78 of the Act. In case of an under estimate, the Commissioner should be notified and the tax assessment for that year should be re-opened in terms of section 79 of the Act.

It is clear that Justice Corbett did not deviate from the international trend. *Golden Dumps* has been cited and applied as reliable references in South African tax law.

The *Edgars* case, however, was an unfortunate case against the taxpayer. Justice Corbett found in a majority decision that the turnover rental was

¹⁸⁴ *Herbert Smith (a firm) v Honour (Inspector of Taxes)* [1999] 173 Chd

contingent upon the turnover for the lease year being determined. It is submitted that the expense did accrue during the year of assessment, but if it is not possible for the taxpayer to calculate the turnover within the time limits before submission is due, then a reasonable estimate can be calculated and should be allowed by the Commissioner. Should this estimate differ from the actual amount then a correction is possible by revising that year's assessment in accordance with section 79.

6.7 CONCLUSION:

6.7.1 Apportionment of expenses:

Justice Corbett applied the apportionment principle in two major cases, *Nemojim* and *De Beers Holdings*, but did not apply it in the *Pick n Pay Wholesalers* and the *Standard Bank* cases (*supra*). In the dividend stripping cases of *Nemojim* and *De Beers Holdings* Justice Corbett used the formula applied in the *Guardian Assurance*¹⁸⁵ case. By apportioning the expense of purchasing the shares between the value of the shares after deducting the dividends which would be declared and the value of the dividends, he effectively closed the loophole for dividend stripping operators.

The *Pick 'n Pay* case was probably the most celebrated of the four cases decided by Justice Corbett regarding the non-apportionment of expenses. Justice Corbett sided with the duality rule¹⁸⁶ and could not distinguish a point

¹⁸⁵ *SIR v Guardian Assurance Holdings (SA) Ltd* 1976 (4) SA 522 (A), 38 SATC 111

¹⁸⁶ *CIR v Pick n Pay Wholesalers*, 49 SATC 132 on p 148

at which the advertising began and the donation ended. With the subsequent changes to section 23(g), apportionment is now possible.

6.7.2 The lack of a profit motive

In the *De Beers Holdings* case, Justice Corbett found it hard to believe that a taxpayer would enter into a transaction without the object of making a profit. In fact, the object appeared to be to make a loss. Justice Corbett interpreted the provisions of section 23(g) to require profits from the taxpayer, in order to disallow substantial deductions. He equated the word “trade” with “profit” so that failing to demonstrate a profit motive indicated that the taxpayer was not trading and hence he could not claim a deduction.

The absence of profit is frowned upon by the authorities, yet the lack of the profit motive is not automatically decisive. Contrary to Justice Corbett’s decision, it is not a requirement of the general deduction formula that a taxpayer should achieve a profit in order to claim a deduction.

6.7.3 The close connection between the expenses incurred and the relevant income earning activities

In delivering the judgments of the *Standard Bank* and *Nemojim* cases (*supra*), Justice Corbett pointed out the importance of the purpose of the expenditure concerned and the closeness of its connection with the relevant income-earning operations (or exempt income received) when applying the general deduction formula (section 11(a) read with section 23(f) and (g)) of the Act).

This principle, introduced by Justice Corbett, has been applied and followed in subsequent court cases¹⁸⁷.

6.7.4 Expenses determined after year end

In *Edgars Stores* and *Golden Dumps* the question of when an incurral of an expense arises, was addressed.

If the outcome of a dispute or court case is not finalised during the course of a financial year, then it is a contingent liability for accounting purposes for that year and it is not deductible for tax purposes as no liability has been established. This principle in relation to legal disputes was introduced by Justice Corbett in the *Golden Dumps* case.

The *Edgars Stores* case, however, was an unfortunate case against the taxpayer. Justice Corbett found in a majority decision that the deduction for turnover rental could not be calculated before the end of the fiscal year as the turnover figure was finalised after the end of the fiscal year. The court decided that the contingency was not fulfilled and thus the deduction of the turnover rental was not allowed in that year of assessment. It is submitted that the expense did accrue during the year of assessment, but if it is not possible for the taxpayer to calculate the turnover within the time limits before submission is due, then a reasonable estimate can be calculated and should be allowed by the Commissioner.

¹⁸⁷ See ITC 1603, 58 SATC 212 and CIR v Tickin Timbers, 59 SATC 60 as discussed in #6.4.1

CHAPTER 7 **SPECIAL DEDUCTIONS – CAPITAL ALLOWANCES**
AND FOREIGN EXCHANGE LOSSES

7.1 **INTRODUCTION: CAPITAL ALLOWANCES AND FOREIGN**
EXCHANGE LOSSES

Section 12A to D of the Income Tax Act provides for capital allowances on certain qualifying plant and machinery. The following are the relevant provisions of section 12C which will be discussed further:

“...in respect of machinery or plant ...and is used by him directly in a process of manufacture ... or any other process carried on by him which in the opinion of the Commissioner is of a similar nature.”

Justice Corbett clarified the definition of “*plant*” and “*process of manufacture*” in two cases, namely: *Safranmark*¹⁸⁸ and *Blue Circle Cement*¹⁸⁹. These two cases are analysed and discussed in this chapter. The definition of “*a process of manufacture*” was later extended in the Act to include processes of “*a similar nature*”.

¹⁸⁸ 1982, (1) SA 113 (A), 43 SATC 235

¹⁸⁹ 1984, (2) SA 764 (A), 46 SATC 21

Justice Corbett's judgement in *CIR v Felix Schuh*¹⁹⁰, on foreign exchange losses, is analysed in part 7.4 of this chapter.

7.2 DEFINITION OF A "PROCESS OF MANUFACTURE"

Justice Corbett rendered a dissenting judgment in *Secretary for Inland Revenue v Safranmark (Pty) Ltd*¹⁹¹. The panel of judges split 3:2 in coming to a decision on the meaning of "*a process of manufacture*".

The taxpayer claimed a deduction for a "machinery initial allowance" and "machinery investment allowance" respectively in terms of the provisions of section 12(1) and 12(2) of the Act (as they then were) for each of the tax years ended 31 May 1974, 1975 and 1976. The taxpayer was the holder of a franchise issued by Kentucky Fried Chicken (Pty) Ltd to prepare and sell "Kentucky Fried Chicken" in a manner prescribed by the holding company.

The Secretary disallowed all the section 12 capital allowances that had been claimed. Evidence given before the Special Court detailed the procedure that had been followed and the machinery and plant that had been used by the taxpayer (as well as by all other like franchise holders) from the receipt of the raw product (pieces of chicken) up to the sale of the finished product (namely 'Kentucky Fried Chicken') to the customer. All the holders of this franchise received chicken pieces from a single supplier. The chicken reached the taxpayer (and all the other franchise holders) in polythene bags, each of which

¹⁹⁰ 1994, 56 SATC 57

¹⁹¹ 1982 (1) SA 113(A), 43 SATC 235

contained eighteen pieces of chicken comprising identical cuts from two birds of specified weight.

The pots that were used were “special patented Kentucky Fried Chicken pots”. Each held exactly five litres of shortening (a vegetable oil) and eighteen pieces of chicken (two birds) and built up pressure of 15 lbs per square inch. Any fried chicken that was not sold within two hours of its removal from the pot was discarded.

Galgut AJA, in the majority judgement, found the taxpayer’s operations to constitute a process of manufacture.

Corbett JA, in his dissenting minority judgement, stated his position as follows:

“Although cooked chicken differs from raw chicken both chemically and in utility, and despite the additives (milk-and-egg dip and breading mix), the taxpayer’s operation – notwithstanding its wide scope – basically consists of cooking pieces of chicken for the purpose of sale to the public.”

He found that the cooking of raw chicken was not “a process of manufacture”.

Jansen JA, Miller JA and Holmes AJA, disagreed with Corbett JA and concurred in the majority judgment of Galgut AJA.

7.2.1 Application of the Safranmark definition (“process of manufacture”)

Both the minority and majority judgements in *Safranmark* were discussed in *Commissioner for Inland Revenue v Stellenbosch Farmers’ Winery Ltd*¹⁹². The court was obliged to and did apply the majority judgement. The taxpayer had claimed “machinery initial and investment allowances” on its wine-making equipment. The court held that the taxpayer engaged in a “process of manufacture” and was therefore entitled to the above-mentioned allowances.

The court had to consider the proposition of whether a particular activity is a “*process of manufacture*” is a question of law or of fact and concluded that it is a question of fact. In considering this proposition, the court relied on the *dicta* of Williamson JA in *Secretary for Inland Revenue v Hersamar*¹⁹³ and Galgut AJA in *Safranmark*. In the *Safranmark* case, Galgut AJA cited with approval the following *dicta* of Grosskopf J in the court *a quo* in that case:

“The expression ‘a process of manufacture’ is not a term of art. ...In the present case it seems relevant to me that a standardised product is produced on a large scale by a continuous process utilising human effort and specialised equipment in an organised manner. When to that is added the factor that the end product is, in terms of its nature, utility and value, essentially different from its main component, the process must, it seems to me, be described as one of manufacture.”

¹⁹² 1988 (CPD), 51 SATC 81

¹⁹³ *Secretary for Inland Revenue v Hersamar (Pty) Ltd*, 1967 (3) SA 177(A), 29 SATC 53 at 186

Safranmark was referred to, discussed and applied in ITC 1465¹⁹⁴. The taxpayer's factory dyed yarn, which process was found to be “a process of manufacture” as the yarn had in fact become a different product, physically and chemically, from the raw yarn.

Justice Friedman referred to Justice Corbett's *dictum* in *Safranmark*¹⁹⁵, namely, that the process “basically consists of cooking pieces of chicken”. Corbett JA had summarised succinctly the following general propositions that could be derived from the decisions:

“(1) *The term ‘process of manufacture’, in the present context, denotes an action or series of actions directed to the production of an object or thing which is essentially different from the materials or components which went into its making.*

(2) *The requirement of ‘essential difference’ necessarily imports an element of degree. This should be decided on the facts of each individual case.*

(3) *When deciding whether a particular activity does or does not fall within the ambit of a ‘process of manufacture’, the ordinary meaning of that phrase in the English language should also be taken into account.”*

¹⁹⁴ 1989 (C), 52 SATC 1

¹⁹⁵ 1982 (1) SA 113 (A), 43 SATC 235

Justice Friedman continued by comparing *Safranmark* to ITC 1465. He said that to analyse and extract general criteria or attributes from a process or operation, which amounts to a process of manufacture, and to conclude that another process to which the same general criteria apply or which exhibits similar general attributes is, therefore, also a process of manufacture, may lead to results not intended by the legislature.

Justice Friedman said that although the Kentucky Fried Chicken produced by the taxpayer in *Safranmark*, remained chicken, the Appellate Division, by a majority of four to one, held that the process to which the raw chicken was subjected, resulted in a new and distinctive product. In the case concerned, the end product produced by the processes involving the use of the plant and machinery at the taxpayer's factory, was in fact a different product.

In ITC 1575¹⁹⁶, the taxpayer, a manufacturer, distributor and lessor of scaffolding and formwork, sought to deduct from its income a "machinery investment allowance" in respect of scaffolding and formwork leased to construction companies in terms of section 12(2) of the Act. The taxpayer contended that it was entitled to a deduction in terms of section 12(2) as the lessees used the leased equipment in a process of manufacture. The onus was on the taxpayer to show, on a balance of probabilities, that the plant used by the lessees was used "*directly in a process of manufacture*". The court found in favour of the taxpayer relying on the *dictum* of Galgut AJA in the *Safranmark's* case (the majority decision):

- (a) that specialised plant and machinery were used;

¹⁹⁶ 1989 (T), 56 SATC 203

- (b) that the method of using the plant and machinery was standardised;
- (c) that human effort and labour were used;
- (d) that the volume of production was based on anticipated demand;
- (e) that the volume of production was large;
- (f) that the end product was different from the materials from which it was produced, not only in nature but also in utility and value in that the ingredients of the milk and egg mixture and of the breading mixture had ceased to exist and the inedible raw chicken had become an edible product;
- (g) that all the above was done for the purpose of *Safranmark's* trade.

In another case, *Automated Business Systems v Commissioner for Inland Revenue*¹⁹⁷, the taxpayer contended that the process utilised by the lessees of the plant of the taxpayer, had all the features which were deemed sufficient in *Safranmark* (the majority decision) to find that it constitutes a process of manufacture. The taxpayer company, *Automated Business Systems*, operated a computer service bureau offering a wide range of services in the electronic data processing field and also developed computer programmes and provided related documentation handling facilities. The taxpayer acquired two data capturing systems ("the machines"). They did not print the background to the statements (the blank statements) but the information thereon. The operations of the appellant company were conducted on a large scale. Its output was 50

¹⁹⁷ 1986 (2) SA 645(T), 48 SATC 41

million lines of print per month or the equivalent of 125 million pages. The activities of the appellant were spread over an area of eight large rooms.

The court held against the taxpayer, based on the majority decision in *Safranmark*. The court found that two important features mentioned in the *Safranmark* case to consider in determining whether there has been a process of manufacture are:

- whether there is a substantial or essential change in the character of the material from which the alleged manufactured articles are made of, also
- whether it can be said that the operations produce a standardised product.

It is submitted that the *Safranmark* majority decision included too wide a range of activities into the definition of a “process of manufacture”. This was illustrated in the *Automated Business Systems* case. In this case the activities were similar to the requirements described in the *Safranmark* case, yet the court ruled it not to be a process of manufacture.

7.2.2 Conclusion on Safranmark

The majority judgement of Galgut AJA in the *Safranmark* case was applied in the *Stellenbosch Farmer’s Winery*, ITC1575 and *Automated Business Machines* cases (*supra*). Justice Corbett’s minority judgement, however, was also referred to in those cases but was not applied since it was deemed to be too strict an interpretation of a section of the Act that is meant to provide an incentive for all forms of manufacturing. Yet, despite the wide interpretation

of the word “*manufacturing*” in the *Safranmark* case by the majority judgement of Justice Galgut, the process in the *Automated Business Systems* case was found not to constitute a process of manufacture.

Section 12 was later amended by the legislature to include a “*similar process*” so that a wider range of business activities could benefit from this tax incentive.

7.3 DEFINITION OF “PLANT”

In *Blue Circle Cement Ltd v Commissioner for Inland Revenue*¹⁹⁸, the majority of the panel of judges supported Justice Corbett’s judgement, in contrast to what had occurred in *Safranmark*. In its factory, the taxpayer manufactured cement, which has limestone as its basic raw material. The taxpayer had established a new limestone quarry and crushing plant at Springbokpan. During the 1975 tax year, the taxpayer completed and began to use an extension of the railway line as far as Springbokpan. The length of this extension was some 41 kilometres and it was constructed at a cost of R2 047 699. The decision to construct the extended railway line was taken after careful consideration of possible alternatives and the rejection of these alternatives on economic grounds. The limestone that was extracted was conveyed on the railway line in issue to the taxpayer’s factory. In its return of income for the 1975 tax year, the taxpayer claimed the deduction of a machinery initial allowance and a machinery investment allowance (25 per

¹⁹⁸ 1984 (2) SA 764(A), 46 SATC 21

cent and 30 per cent respectively) in terms of section 12 of the Act. According to the section (as it then was), the aforementioned allowances were claimable

“in respect of new or unused machinery or plant which is brought into use by any taxpayer for the purposes of his trade . . . and is used by him directly in a process of manufacture carried on by him”.

The Special Court dismissed the appeal, holding that *“the railway line is not used directly in the manufacturing process”*.

Counsel for the taxpayer conceded before the Appellate Division that the railway line in issue was not “machinery”, but, relying upon dictionary definitions and various decisions of English courts in similar contexts, submitted that, on the facts, the said railway line was “plant” within the meaning of section 12 of the Act.

Counsel for the Commissioner submitted somewhat tentatively, that “plant” should be accorded a restrictive meaning that approximates ‘machinery’. Counsel relied primarily on the submission that, because of its length and the distance between the works at Springbokpan and the factory at L, the railway line in issue could not be regarded as being “plant”.

The court held that the railway line in issue was “plant” within the meaning of section 12 of the Act and that the taxpayer was therefore entitled to the allowances claimed.¹⁹⁹

To explain the court’s decision, Corbett JA stated the following²⁰⁰:

“The railway line, though needing periodic maintenance and repair, is durable and is intended to last the life of the limestone deposits at Springbokpan. In my opinion, it has all the characteristics of plant. ...The line is used solely for the purpose of conveying crushed limestone from Springbokpan to the factory. The line is like a very long conveyor belt leading from the crushing plant to the factory.”

“...For these reasons I am of the view that, contrary to the finding of the Special Court, the railway line constructed by taxpayer did

¹⁹⁹ Justice Corbett referred to certain English cases that dealt with the provisions of the English fiscal legislation, which authorised allowances to be made in respect of capital expenditure incurred by a person carrying on a trade.

The starting point in all English cases was the famous *dictum* of Lindley LJ in *Yarmouth v France*(1887) 19 QBD 647 in which the judge said the following in regard to the meaning of the word ‘plant’: *“There is no definition of plant in the Act: but, in its ordinary sense, it includes whatever apparatus is used by a businessman for carrying on his business – not his stock-in-trade which he buys or makes for sale; but all goods and chattels, fixed or movable, live or dead, which he keeps for permanent employment in his business.”*

²⁰⁰ At p 32 of 46 SATC 21

constitute 'plant' within the meaning of that term in sections 12(1) and 12(2)."

Having referred to these definitions, Corbett JA in the *Blue Circle* judgement went on to state that²⁰¹:

"The enquiry is thus whether the items alleged to be 'plant' constituted fixtures, implements, machinery or apparatus used in carrying on any industrial process."

Corbett JA referred to two tests that had been laid down in the English cases. The first of these was the so-called "functional test" and the second was what could be described as the "durability test". The functional test provides the criterion to be applied in respect of whether the subject matter is the apparatus or part of the apparatus that is employed in carrying on the activities of the taxpayer's business. If it is, then it is plant. If it is not, then, despite whatever other characteristics it may have, it is not plant.

Corbett JA stated the durability test as follows:

"In addition, it has been held that the word 'plant' connotes some degree of durability and would not include articles which are quickly consumed or worn out in the course of a few operations."

For this purpose the learned judge referred to the case of *Hinton (Inspector of Taxes) v Maden & Ireland, Limited*.²⁰²

²⁰¹ At p 32 of 46 SATC 21

²⁰² [1959] 3 All ER 356(HL).

Corbett JA ended his discussion of the meaning of the word “plant” by saying:

“Of course, ultimately each case must be decided by a careful consideration of its own particular facts and by a common sense approach to what subject-matter can, and what subject-matter cannot, properly be classified as ‘plant’.”

7.3.1 Application of the definition of “plant” as espoused in the *Blue Circle* case

The definition of “plant” as applied in *Blue Circle* was cited in ITC 1447²⁰³. In that case, a co-operative society claimed the deduction of a special machinery allowance on the construction costs of access lines and sidings that connect silos with the railway lines to enable agricultural products in the silos to be loaded directly onto trucks.

The court held that the *Blue Circle* and other decisions, on which the taxpayer relied, were not applicable in the case and that the ‘integral whole’, ‘part and parcel’ or ‘functional’ criteria enunciated in those cases had no application in the present case. The taxpayer was therefore not entitled to the allowances claimed.

In ITC 1468²⁰⁴, the taxpayer, a shoe manufacturer that used cutting knives and lasts in its production processes, claimed a manufacturing investment allowance that was based on the assumption that it was a manufacturer. It was held that, while each case should ultimately be decided on its own facts, the

²⁰³ 51 SATC 53 at 56-57

²⁰⁴ 1989 (C), 52 SATC 32 at 35 & 38

general approach to the use of functional and durability tests in an enquiry by the English courts, and which had been referred to in *Blue Circle Cement Limited v Commissioner for Inland Revenue*, may usefully be applied in the interpretation of “plant” as used in section 12 of the Act. The court also found that, for the purposes of section 12(2)(c), the cutting knives and lasts should accordingly be treated as “plant”.

In ITC 1469²⁰⁵, a printing and packaging firm which used small capital items in its printing presses and cutting and creasing dies, claimed a machinery allowance. It was held that the definition of “plant” that had been given by Lindley LJ in *Yarmouth v France*²⁰⁶ and approved in *Blue Circle Cement Limited*²⁰⁷ should be applied, that is, “plant” includes “whatever apparatus is used by a businessman for carrying on his business, not his stock-in-trade ... that he keeps for permanent employment in his business”. On this basis the court held that the printing presses were “plant” and approved the machinery allowance.

In ITC 1479²⁰⁸, the court had to decide what constitutes a “process of manufacture”. In particular, the court had to decide whether the site manufacture and the erection of transmission line towers, including the laying

²⁰⁵ 1989 (C), 52 SATC 40 at 43-4 & 45

²⁰⁶ (1887) 19 QBD 647 at 658

²⁰⁷ 1984(2) SA 764(A), 46 SATC 21

²⁰⁸ 1989 (T), 52 SATC 264 at 273-4

of foundations and the site stringing operations, constituted a “*process of manufacture*” within the meaning of section 12(2)(c) of the Act.

Justice Melamet relied on the *dicta* in *Blue Circle Cement (supra)*:

”As the facts show the process of manufacture commences at the [taxpayer’s] works at Springbokpan, where the limestone is quarried, crushed. The next stages of the manufacturing process are necessarily performed at taxpayer’s factory in Lichtenburg, some forty odd kilometres away. Obviously this circumstance compels the [taxpayer] to provide some form of conveyance for the crushed limestone from Springbokpan to Lichtenburg. ...The function performed by the railway line is, in my opinion, part and parcel of the taxpayer’s industrial process and I can see no reason why the railway line should not be regarded as apparatus used in carrying on the industrial process of manufacturing cement.”

The court was therefore of the opinion that the process of manufacturing a tower continued until such time as the tower was completed and laid out in a horizontal position at the site where it was to be erected. The plant and machinery that were used at the site to complete the fabrication of the tower to the stage at which it was laid out on the ground in a horizontal position were therefore used in a process of manufacture and the taxpayer was entitled to the relevant deduction provided for in section 12(2) of the Income Tax Act.

7.3.2 The definition of “plant” in the United Kingdom

Justice Corbett made several references to English law in the *Blue Circle* case. He based his definition of “plant” on cases in the United Kingdom as there

were no cases to refer to in South Africa. Income tax legislation in the United Kingdom, like South Africa, does not define a “process of manufacture” for the purposes of claiming capital allowances. Case law, however, endeavours to define the meaning of “plant”. One of the best known statements concerning the meaning of “plant” in the United Kingdom is that of Lindley L.J. in *Yarmouth v. France*²⁰⁹, namely:

"...in its ordinary sense, it includes whatever apparatus is used by a businessman for carrying on his business, - not his stock-in-trade which he buys or makes for sale; but all goods and chattels, fixed or movable, live or dead, which he keeps for permanent employment in his business."

The above-mentioned test led Lindley L.J., in common with the other members of the court, to hold that a cart-horse belonging to the defendant was "plant" within the meaning of section 1 of the Employers' Liability Act, 1880. However, in *London and Eastern Counties Loan and Discount Co. v. Creasey*²¹⁰ cab-horses were held not to be "plant" within the meaning of section 6 of the Bills of Sale Act, 1882. The reason for this finding was that in the latter statute the word "plant" appeared in a context that required the conclusion that it should be read in a restricted sense.

²⁰⁹ *Yarmouth v. France* (1887) 19 QBD 647

²¹⁰ *London and Eastern Counties Loan and Discount Co. v. Creasey* (1897) 1 QB 442

According to Lord Donovan in *Inland Revenue Commissioners v Barclay, Curle & Co Ltd*²¹¹ there are three main submissions regarding the meaning of the word “plant”. Firstly, the fact that the object concerned is a structure or forms part of a structure which is not itself plant, does not exclude the possibility of the object being considered to be plant. Secondly, the question to be answered is whether the object concerned is something “with” which the taxpayer carries on his business rather than something “in” which he carries on his business. Thirdly, if there is a test to determine whether an object is plant, the test is what has been described as "the functional test" as applied in *Inland Revenue Commissioners v Barclay, Curle & Co Ltd, (supra)*²¹² in which Lord Donovan stated that:

“Some plant may perform its function passively and not actively.”

In this case the taxpayer company carried on the trade of a shipbuilder, repairer and engineer. Between 1962 and 1965, the taxpayer had constructed a dry dock and claimed the full cost of excavation and construction as plant for the purpose of a capital allowance. The taxpayer contended that the dock was subject to wear and tear, but, if it were properly maintained, it might last some 80 to 100 years. The Crown contended that each item had to be considered separately in order to determine whether it was plant or machinery.

²¹¹ *Inland Revenue Commissioners v Barclay, Curle & Co Ltd* [1969] 1 All ER 732

²¹² at p 691

The court held that both items of expenditure, excavation and construction, were incurred on the provision of plant or machinery. Lord Guthrie remarked:

“In deciding whether expenditure qualifies for capital allowances the crucial question is the object of the expenditure.”

In *Jarrold v John Good & Sons Ltd*²¹³, the taxpayer claimed initial allowances in respect of expenditure incurred in connection with the installation of moveable partitions that had been installed by shipping agents to satisfy the taxpayer’s fluctuating accommodation requirements. It was held that the partitioning was plant. It was pointed out that *“...the setting in which the business is carried on and the apparatus used for carrying on that business are not necessarily exclusive”*.

7.3.3 The definition of “plant” in Australia

At the time when the *Blue Circle* case was decided, Australian judgements were also available as to how that county interpreted the meaning of “plant”.

In *Carpentaria Transport (Pty) Ltd v Federal Commissioner of Taxation*²¹⁴, the objection that was lodged, claimed that certain roller shutter doors were plant or articles for the purposes of section 54 of the Income Tax Assessment Act 1936 and were also the subject of an investment allowance in terms of

²¹³ *Jarrold v John Good & Sons Ltd* [1962] 2 All ER 971

²¹⁴ *Carpentaria Transport (Pty) Ltd v Federal Commissioner of Taxation* (1990) 21 ATR 513; 90 ATC 4590).

section 82AA of their Act. The tribunal concluded that the roller shutter doors were not plant, but that they formed an integral part of a building structure, which was not plant. The tribunal held that the roller doors formed a part of the setting in which the warehouse operation was conducted. The tribunal referred to *Quarries Ltd v FCT*²¹⁵ as the authority on the issue. The taxpayer claimed investment allowances on the sleeping units that provided accommodation for employees while they were engaged in operations. The court found that the “structural improvements”, which provide accommodation for employees, cannot be regarded as "plant" and therefore the term cannot accommodate the sleeping units in question.

In *Macquarie Worsteds Pty Ltd v FCT*²¹⁶, the taxpayer submitted that the ceiling of a building constituted plant for the purposes of claiming an allowance. The court decided that the ceiling appeared to perform no other function, in relation to the taxpayer's operations, than would be performed by any normal ceiling. In this regard Mahoney J stated:

“I do not think that the fact that the nature of the taxpayer's operations makes it expedient that the building has a ceiling means that the ceiling is part of the plant with which the operations are conducted.”

The definition of “plant” in Australia was in line with Justice Corbett’s definition at the time as they had also applied the “functional test” and the “durability test” derived from English tax law.

²¹⁵ (1961) 106 CLR 310; 8 AITR 383

²¹⁶ *Macquarie Worsteds Pty Ltd v FCT* (1974) 4 ATR 334; 74 ATC 4121

7.3.4 **Conclusion on the definition of “plant” and “a process of manufacture”**

The wording of section 12 of the Act was changed to include “a process of manufacturing or a similar process” as a result of the narrow definition provided by Justice Corbett in the *Safranmark* case. In *Stellenbosch Farmer’s Winery* it was stated that the intention of Parliament was to provide a tax incentive for investment in plant and equipment used in a manufacturing process and the initiative was to be applied as widely as possible, since capital allowances are intended to be incentives in the context of the economy. Very rigid and stringent rules regarding these allowances may be counterproductive for the achievement of the purpose for which the incentives were introduced into the Act.

In *CIR v Stellenbosch Farmers’ Winery Ltd (supra)*, the view was expressed that the word “manufacturing” — and, presumably, by implication, the words “process of manufacture” — should be given a wide meaning in order to promote the aims of the legislature in attaching industrial concessions to the tax law.

The “general propositions” that may be derived from many of the cases that have been referred to were summarized by Corbett JA, in his judgement in *SIR v Safranmark (Pty) Ltd*. These general propositions are:

- (1) The term “process of manufacture”, denotes an action or series of actions that are directed at the production of an object which

is essentially different from the materials or components that went into its making.

- (2) The requirement of “essential difference” necessarily imports an element of degree and should be decided on the grounds of the facts of each case.
- (3) The ordinary, natural meaning of that phrase in the English language should be taken into account.

The decisions in the United Kingdom and Australia, generally accepted that a capital allowance is an incentive that governments devise to promote manufacturing (in all of its forms) by means of tax incentives. This may be the reason why courts and revenue authorities have been more lenient in granting capital allowances to taxpayers when considering the issue of “plant” and “the process of manufacturing or similar process” rather than in other areas of tax law. Virtually all forms of manufacturing and its associated plant are allowed for this purpose. It appears as if Justice Corbett overlooked the incentive programme for manufacturing. His formative approach in the *Safranmark* case appears to be rigid, in comparison with the majority judgement.

In Australia some taxpayers tried to take advantage of this incentive and their claims were disallowed, as indicated in *Carpentaria Transport (Pty) Ltd v Federal Commissioner of Taxation*, *Quarries Ltd v FCT* and *Macquarie Worsted Pty Ltd v FCT*. It became necessary for the legislator to define in precise terms the wording of section 12 in order to curb the abuse of tax

incentives, such as claiming initial allowances on ceilings as happened in the *Macquarie Worsted* case (*supra*).

7.4 THE DEDUCTIBILITY OF FOREIGN EXCHANGE LOSSES

Justice Corbett delivered the majority judgement on the deductibility of unrealised foreign exchange losses in *Commissioner For Inland Revenue v Felix Schuh (SA) (Pty) Ltd*²¹⁷: In 1983, the taxpayer received the proceeds of a loan in Deutschmark. The loan was repayable in Deutschmark (“DM”). During 1983, the value of the rand against the DM declined substantially. The indebtedness of the taxpayer increased accordingly. The taxpayer claimed the increase in the loan as a deductible loss in its income tax return for the 1983 tax year. The Commissioner for Inland Revenue apparently allowed the deduction of this loss in the assessment of the taxpayer’s taxable income for that tax year.

During the 1984 tax year, another loan was granted to the taxpayer by its holding company and this loan was also payable in DM. The value of the rand continued to decline against the DM. In its income tax return for the 1985 tax year, the taxpayer again claimed the foreign exchange loss as a deduction against its taxable income, but the Commissioner for Inland Revenue disallowed the deduction. The taxpayer’s main submission was that the

²¹⁷ 1994 (A), 56 SATC 57

deduction of the foreign exchange loss that it had claimed was justified on the authority of the *Caltex* case²¹⁸.

Corbett CJ held that the loss would only be deductible in the year of repayment, because only then would such a loss have actually been incurred. The foreign exchange loss that the taxpayer claimed as a deduction under section 11(a) was not a loss “*actually incurred . . . in the production of the income.*” Accordingly, the taxpayer was not entitled to deduct the loss as being an “unrealized loss” that resulted from exchange rate variations.

7.4.1 Conclusion on the treatment of foreign exchange losses:

The principle that unrealised foreign exchange losses are not deductible is not part of the South Africa’s tax law anymore. Section 24I on the taxability of foreign exchange profits and losses, was introduced after the *Felix Shuh* case. “Actually incurred” according to section 11(a) is not the only criteria applicable to foreign exchange transactions. Section 24I now has to be applied to foreign exchange transactions. According to section 24I, foreign exchange profits and losses, realised and unrealised, are taxable or deductible. The inclusion of this principle in the Act is different to the outcome of the *Schuh* case. The outcome of the *Felix Shuh* case has thus been overruled by subsequent legislation.

²¹⁸ *Caltex Oil(SA) Ltd v Secretary for Inland Revenue, 1975(1) SA 665(A)*

7.5 CONCLUSION

Process of manufacture

Justice Corbett's minority judgement in the *Safranmark* case is considered to be too strict an interpretation of a section of the Act that is meant to provide an incentive for all forms of manufacturing and although referred to in subsequent cases, was never applied.

On the other hand the *Safranmark* majority decision has always been applied although, it is submitted, it includes too wide a range of activities in the definition of a "*process of manufacture*". The problem has been settled by the legislature with an amendment to section 12 to include a "*similar process*" to "*a process of manufacture*", so that a wider range of business activities could benefit from this tax incentive.

Definition of "plant"

Justice Corbett's definition of "plant" in *Blue Circle Cement* has been followed in subsequent cases. He referred to two tests that had been laid down in the English cases. The first of these was the so-called "functional test" and the second was what could be described as the "durability test". The functional test provides the criterion to be applied in respect of whether the subject matter is the apparatus or part of the apparatus that is employed in carrying on the activities of the taxpayer's business. If it is, then it is plant. If it is not, then, despite whatever other characteristics it may have, it is not plant.

The durability test implies that the word 'plant' connotes some degree of durability and would not include articles which are quickly consumed or worn out in the course of a few operations.

Foreign exchange losses

Justice Corbett held in the *Felix Shuh* case (*supra*) that the loss would only be deductible in the year of repayment, because only then would such a loss have actually been incurred. The foreign exchange loss that the taxpayer claimed as a deduction under section 11(a) was not a loss "*actually incurred . . . in the production of the income.*" Accordingly, the taxpayer was not entitled to deduct the loss as being an "unrealized loss" that resulted from exchange rate variations.

Section 24I which deals with the taxability of foreign exchange profits and losses, was introduced after the decision in the *Felix Shuh* case. Section 24I applies to all foreign exchange transactions. In terms of section 24I, all foreign exchange profits and losses, realised and unrealised, are now taxable or deductible.

CHAPTER 8 **THE HIERARCHY OF DOUBLE TAX**
AGREEMENTS IN RELATION TO THE
INCOME TAX ACT

8.1 **INTRODUCTION**

For many years, South Africa has had double tax agreements (“DTAs”) or tax treaties with other countries. Some DTAs were in operation before 1962, when the new Income Tax Act was promulgated, but after 1994 many more such agreements have been entered into.

In the case described below, the Commissioner appeared to be under the impression that the double tax agreement in question had a lower status than that of the Income Tax Act or that it was not compliant with the Act. Justice Corbett pointed out that, in terms of section 108 of the Income Tax Act, DTAs are part of the Act and in fact overrule domestic legislation.

In the United Kingdom changes to legislation were introduced to combat the avoidance of tax by using DTAs between the United Kingdom and tax havens. Unlike the UK legislation, there are no sections in the South African Income Tax Act that override the articles of any DTA.

8.2 A DOUBLE TAX AGREEMENT IS PART OF THE INCOME TAX ACT.

In *Secretary for Inland Revenue v Downing*, 1975 (A), 37 SATC 249, the court was asked to determine whether a DTA overrides the Income Tax Act. In 1960, the taxpayer, who had previously been resident and domiciled in South Africa, went to live in Switzerland on a permanent basis. When he departed from South Africa in 1960, he delegated his authority to S (with whom he had had dealings since 1948) to manage his portfolio with the objective of yielding the greatest possible income for the taxpayer to enjoy in Switzerland.

P held the taxpayer's power of attorney, retained custody of his shares, collected his dividends and kept his accounts. Pursuant to his mandate, S sold and purchased shares on the taxpayer's behalf. He did not consult with the taxpayer in advance, but merely informed him and P of each transaction after it had been concluded. Article 3(1) of the Double Tax Agreement between South Africa and Switzerland stated the following:

“The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein ...”

The term “*permanent establishment*” is defined comprehensively in article 5 of the DTA. Paragraph 5 of article 5 reads as follows:

“An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other state through a broker, general commission agent or any other agent of an independent status, where such persons are acting in the ordinary course of their business.”

Justice Corbett held that paragraph 5 of article 5 of the DTA should be construed to mean that, when a Swiss resident does no more than carry on business through a South African broker and the latter, in transacting that business on behalf of his Swiss principal, acts in the ordinary course of his business, the Swiss resident must be deemed not to have a ‘permanent establishment’ in South Africa. The appeal was accordingly dismissed.

He also pointed out the significance of the convention between the two states of South Africa and Switzerland. He noted that the convention was signed on behalf of the Government of the Republic of South Africa and of the Swiss Federal Council and was notified by proclamation in South Africa, in terms of s 108(2) of the Act, on 29 September 1967. While in force it applies, in South Africa, to any year of assessment beginning on or after 1 March 1965. The effect of the proclamation is that, as long as the convention is in operation, its provisions have effect as if enacted in terms of section 108(2) of the Act. The terms of the convention are based upon a model convention contained in the 1963 report of the fiscal committee of the Organization for European Economic Co-operation and Development (OECD). This model has served as the basis for the veritable network of double taxation conventions existing between this country and other countries.

The articles of the convention will override the sections of the South African Income Tax Act. This interpretation by Justice Corbett was applied and followed in several subsequent court cases.

8.2.1 Application of the *Downing* case

In ITC 1544²¹⁹, reference was made to the judgement in the *Downing* case. ITC 1544 concerned the question of whether a non-South African company was justified in claiming a refund of non-residents shareholder's tax on the grounds that the imposition of such a tax contravenes the non-discrimination clause, that is, article 25(1), contained in the DTA that had been concluded between the Republic of South Africa and the Netherlands. The taxpayer claimed a refund of NRST in terms of section 102(1) of the South African Income Tax Act.

It was held that the taxpayer had discharged the onus of proving that NRST had been wrongly deducted from the dividends paid to it and that it was entitled to the refund of the amounts already paid over to the Commissioner. This decision was based on the principle established in *SIR v Downing*, namely that:

“The effect of section 108(2) of the Act is to grant statutory relief in certain circumstances where the South African Act imposes a tax, where the provisions of a double-tax Convention grants an immunity or exemption from such tax to persons governed by the Convention. Tax is not payable to the extent to which an immunity or exemption

²¹⁹ ITC 1544 (1992), 54 SATC 456

from tax is granted in terms of a binding double tax Convention which has been proclaimed and thus has statutory effect.”

8.3 Conclusion

Double Tax Agreements form part of the Income Tax Act. Section 108(2) of the Act states that:

“... after the approval by Parliament of any such agreement...and the arrangements so notified shall thereupon have effect as if enacted in this Act.”

In the *Downing* case (*supra*) Justice Corbett concluded that a double tax agreement is signed on behalf of the governments of the Republic of South Africa and the other country. In South Africa it is ratified by proclamation in terms of section 108(2) of the Act. The effect of the proclamation, according to Justice Corbett, is that as long as the convention is in operation, its provisions, as far as they relate to immunity, exemption or relief in respect of income tax in the Republic, have the same effect as if they were enacted in Act 58 of 1962 (see section 108(2)).

He further stated that in South Africa, legislation intended that the status of tax agreements should override that of the Income Tax Act. No provision in the internal laws of South Africa can override a double tax agreement, unless it is specifically provided for in the double tax agreement. Although this rule generally applies to most countries, it does not apply to all countries. An investigation of a country's income tax act and Constitution will reveal

whether the double tax agreement overrides the provisions of its income tax act.

CHAPTER 9 **THE PRINCIPLE OF LEGITIMATE EXPECTATION**
AND THE NEW CONSTITUTION

9.1 **INTRODUCTION**

The adoption of new principles of law from other legal systems can impact upon and expand our common law and this is the case even in tax matters. One such adaptation is the principle of legitimate expectation.

The principle of legitimate expectation is the protection of an individual's expectation that a particular decision will be taken by the state based on an act or advice from state officials. In *National Director of Public Prosecutions v Phillips and Others*²²⁰, Hefer J stated that:

“The requirements for legitimacy of the expectation include the following:

- (i) The representation underlying the expectation must be clear, unambiguous and devoid of relevant qualification . . .*
- (ii) The expectation must be reasonable: . . .*
- (iii) The representation must have been induced by the decision-maker*
- (iv) The representation must be one which it was competent and lawful for the decision-maker to make without which the reliance cannot be legitimate. .”.*

²²⁰ 2002 (W), 4 SA 60 at p 28

In 1989, in the *Traub* case²²¹, Justice Corbett introduced into the South African legal system the principle of legitimate expectation, a principle that has had a far-reaching impact on the prevailing common law.

9.2 **THE PRINCIPLE OF LEGITIMATE EXPECTATION.**

In the case of *Traub*, the applicants, all medical interns, stated that they had been offered positions at Baragwanath Hospital by the Administrator of Transvaal. They were employed as interns and practitioners and were given the impression that they would be offered full-employment contracts upon the completion of their internship. The Administrator then changed his mind and did not offer such contracts to these prospective employees. Their applications were rejected by a provincial director of hospital services, solely because they had been party to a published letter that severely criticised the Provincial Administration's attitude to the conditions prevailing in the Hospital. The director concerned considered these dissenting medical practitioners to be unsuitable for the post for which they had applied. The Administrator did not formally give them reasons for the decision, nor did he permit a hearing at which they could discuss the issue or voice their concerns.

The court found in favour of the applicants. To “observe the principles of natural justice”, Corbett CJ said at 761E–H that:

“The law should in such cases be made to reach out and come to the aid of persons prejudicially affected. At the same time, whereas the

²²¹ Administrator, Transvaal and others v Traub and Others, 1989, (4) SA 731 (A)

concepts of liberty, property and existing rights are reasonably well defined, that of legitimate expectation is not. Like public policy, unless carefully handled it could become an unruly horse. And, in working out, incrementally, on the facts of each case, where the principle of legitimate expectation applies and where it does not, the courts will, no doubt, bear in mind the need from time to time to apply the curb. A reasonable balance must be maintained between the need to protect the individual from decisions unfairly arrived at by public authority (and by certain domestic tribunals) and the contrary desirability of avoiding undue judicial interference in their administration.”

9.3 THE PRINCIPLE OF LEGITIMATE EXPECTATION IN ENGLISH LAW.

The principle of legitimate expectation was initially recognized in English law by the renowned Lord Denning in the *Schmidt*²²² case. The plaintiffs, all foreigners, were students at the Hubbard College of Scientology. They were granted permits for a limited sojourn in the United Kingdom for the purpose of full-time study at a recognised educational institution. The secretary of the Hubbard College applied to the Home Secretary, on behalf of the plaintiffs, for an extension of their sojourn to enable them to complete their studies. Before a reply to the applications was received, the government announced that it was satisfied that Scientology was socially harmful and that, although there was no power under the existing law to prohibit the practice of Scientology, the government would take steps to curb its growth. One of the steps to be taken was that foreign nationals who were already in the United Kingdom for the purpose of attending Scientology establishments would not be granted an

²²² *Schmidt and Another v Secretary of State For Home Affairs*, [1969] 1 All ER 904

extension of stay to continue their studies. In July 1968, the Home Secretary rejected the plaintiffs' application for an extension of stay. The plaintiffs issued a writ, on behalf of themselves and fifty other foreign students of the Hubbard College, claiming that the Home Secretary's decision not to consider any application for an extension of stay that was made on behalf of a student of Scientology, was unlawful and void and that he was obliged to consider such application on its merits and in accordance with natural justice.

Lord Denning MR, held that an administrative body may, in a proper case, be bound to give a person who is affected by its decision, an opportunity to make representations. Lord Denning stated that it all depends on whether the person concerned has some right or interest, or some legitimate expectation, of which it would not be fair to deprive him without hearing what he has to say.

In his *obiter dictum*, Lord Denning continued by stating that the statute gave immigration officers complete discretion to refuse an application. They were under no obligation to tell the foreigner why he had been refused admission and were not bound to give him an opportunity to make representations. A foreigner does not have the right to enter the country other than by virtue of permission granted to him to enter for a limited period. If he is given leave to enter for a limited period, he does not have the right to stay for a day longer than the permitted period. If his permit is revoked *before* the permitted period expires, he ought to be given an opportunity to make representations, because he would have a *legitimate expectation* of being allowed to stay for the permitted period.

9.4 APPLICATION OF THE PRINCIPLE OF LEGITIMATE EXPECTATION IN SOUTH AFRICAN TAX LAW

In *Contract Support Services (Pty) Ltd and Others v Commissioner for SARS*²²³, the Commissioner obtained a search warrant against the taxpayer in order to determine whether there had been non-compliance by any persons with regard to the obligations imposed on them by the Value-Added Tax Act 89 of 1991. VAT assessments had been issued to the taxpayer and the Receiver of Revenue had appointed Standard Bank of South Africa Ltd as the taxpayer's agent in terms of section 47 of the Value-Added Tax Act 89 of 1991. The taxpayer applied for interim orders for the review and setting aside of the decision to issue notices in terms of section 47 of Act 89 of 1991. The taxpayer contended, with reference to the principle of legitimate expectation, that:

- (i) The principle of *audi alteram partem* should have been observed by all the decision makers who authorised the administrative action referred to in the notice of motion.
- (ii) As the appointment of the bank as the agent took place before the assessments were issued, the issue of the section 47 notice was *ultra vires*.
- (iii) The notices issued in terms of section 47 should be set aside, because the amounts of VAT referred to as being payable therein were in issue as an objection to them had been lodged.

²²³ 61 SATC 338, Also cited as 1999 (3) SA 1133 (WLD)

It was held that not all administrative acts require the application of the *audi alteram partem* principle before they are put into effect. Furthermore, section 47 itself requires no prior hearing and, in addition, the requirement of a prior hearing would defeat the very purpose of the notice by alerting the defaulting VAT taxpayer and, in so doing, enabling the taxpayer to receive payment of the funds due and providing him with an opportunity to spirit such funds away. Where prior notice and a hearing would render the proposed act nugatory, no such prior notice or hearing is required and, by necessary implication, the provisions of section 47 exclude the *audi alteram partem* principle. The application was therefore dismissed.

In *Carlson Investments Share Block (Pty) Ltd v Commissioner for South African Revenue Services*²²⁴, the taxpayer contended that its right to fair administrative action had been infringed. The alleged infringement had occurred in circumstances in which the Commissioner had revised an assessment, within the three-year period, after a decision had been taken to allow an objection thereto. This action had resulted in unfairness by reason of the fact that taxpayers are “entitled” to rely upon the “finality” of a decision that allows an objection. The Commissioner had initially disallowed the deduction of interest that had been paid by the taxpayer in terms of section 11(a), but later allowed the deduction. However, in the light of a (separate) decision of the Supreme Court, the Commissioner later reversed his decision to allow the deduction of interest.

²²⁴ 63 SATC 295

It was held that the taxpayer's reliance on the principle of legitimate expectation was without substance as the Commissioner had an express power as well as an obligation to revisit a tax assessment and that this power had been granted to the Commissioner in the national interest. There was therefore no justifiable charge of an abuse of power.

In *COT v Astra Holdings (Private) Ltd t/a Puzey & Payne*²²⁵, the Supreme Court of Zimbabwe overturned the decision of the court *a quo*, which court had recognised the principle of legitimate expectation in the matter. Its overturning represented a major setback for Zimbabwean taxpayers who had hoped to rely on the principle of legitimate expectation in circumstances in which they have acted on the advice that was provided by the revenue authorities. Malaba JA, who delivered the judgment of the court, noted that section 5(1)(b) of the Zimbabwean Income Tax Act imposed upon a motor dealer the obligation to pay the tax charged and collected on the sale value of a motor vehicle that he has sold to a member of the public. The tax was payable by the motor dealer when the purchase price on which it was levied was in his possession, that is, after the sale transaction has been completed. On the authority of *HTV Ltd v Price*²²⁶, the error of law committed by the revenue officer who had written a letter²²⁷ to the taxpayer confirming that no

²²⁵ 66 SATC 79

²²⁶ [1976] 1 CR 170

²²⁷ The letter exempted all sales in foreign currency from sales tax, it stated:

*“SALES TAX: EXEMPTION FROM TAX ON GOODS BOUGHT
USING MONEY FROM A FOREIGN SERVICE*

tax was payable, had already brought about unfairness to the *fiscus* by depriving it of the sales tax which was due to it. Continued maintenance of the *status quo* would have resulted in further injustice.

In answering the question whether the Commissioner had bound himself to accept as valid the actions of the taxpayer regarding the non-payment of the sales tax that had been based upon the error of law, the answer would be that such an arrangement would be null and void *ab initio* as it was a bargain that the Commissioner could not make at law. Condoning the action of the taxpayer would be tantamount to the Commissioner being in breach of his statutory duty to collect the tax that is due to Revenue. It is one thing for Revenue to enter into an arrangement with a taxpayer on how, in the exercise

I refer to our telephone interview on 4 May 1995 concerning the above mentioned subject.

This is to confirm that goods or services bought using foreign funds (money from a foreign source) are exempt from sales tax.

'Foreign source' in this case means:

- 1 Payment using foreign bank drafts.*
- 2 Payment using foreign cheques.*
- 3 Payment using foreign credit cards*

but does not include payment in Zimbabwe cash.

I hope this clarifies the issue."

of its managerial powers, it would collect tax, but it is another for it to seek to decide that a particular tax that had been imposed by Parliament is not due by a taxpayer, when in fact it is, and in so doing disclaim the right to the tax and abandon the statutory power to collect it.

It is submitted that the reasoning behind Zimbabwean decision would not apply in South Africa, as reliance needs to be placed, in many instances, on the decision of an officer of the state. The Income Tax Act itself recognizes this²²⁸In addition section 33 of the Constitution²²⁹ read together with the Promotion of Administration Justice Act²³⁰ formally recognizes the legitimate expectation principle.

²²⁸ In many instances the Commissioner has to exercise his discretion, for example

- section 81(2): extension for a late objection, or
- section 11(e): the wear and tear allowance is dependant upon what the Commissioner finds to be just and reasonable

²²⁹ Constitution of the Republic of South Africa, 1996, section 33 states:

- 1) Everyone has the right to administrative action that is lawful, reasonable and procedurally fair.
- 2) Everyone whose rights have been adversely affected by administrative action has the right to be given written reasons.
- 3) National legislation must be enacted to give effect to these rights, and must
 - a) provide for the review of administrative action by a court or, where appropriate, an independent and impartial tribunal;
 - b) impose a duty on the state to give effect to the rights in subsections (1) and (2); and
 - c) promote an efficient administration.

²³⁰ In its preamble the Promotion of Administrative Justice Act 3 of 2000, states that it is

- to promote an efficient administration and good governance; and
- create a culture of accountability, openness and transparency in the public administration or in the exercise of a public power or the performance of a public function, by giving effect to the right to just administrative action.

9.5 THE PROMOTION OF ADMINISTRATIVE JUSTICE ACT

The Promotion of Administrative Justice Act²³¹ was introduced in 2000. The purpose of this Act is to streamline the interaction between government departments and citizens in order to ensure that the interaction is just, fair and reasonable. Naturally, it includes the interaction between SARS and taxpayers.

The Promotion of Administrative Justice Act incorporates the principle of legitimate expectations into the South African law, including taxation.

²³¹ Promotion of Administrative Justice Act 3 of 2000.

Section 3: Procedurally fair administrative action affecting any person

- 1) Administrative action which materially and adversely affects the rights or legitimate expectations of any person must be procedurally fair.
- 2)
 - a) A fair administrative procedure depends on the circumstances of each case.
 - b) In order to give effect to the right to procedurally fair administrative action, an administrator, subject to subsection (4), must give a person referred to in subsection (1)
 - c) adequate notice of the nature and purpose of the proposed administrative action;
 - d) a reasonable opportunity to make representations;
 - e) a clear statement of the administrative action;
 - f) adequate notice of any right of review or internal appeal, where applicable; and
 - g) adequate notice of the right to request reasons in terms of section 5.
- 3) In order to give effect to the right to procedurally fair administrative action, an administrator may, in his or her or its discretion, also give a person referred to in subsection (1) an opportunity to
 - a. obtain assistance and, in serious or complex cases, legal representation;
 - b. present and dispute information and arguments; and
 - c. appear in person.

Section 3 of the Promotion of Administrative Justice Act embodies the entire theory of the principle of legitimate expectation.

In ITC 1751²³², the taxpayer company was in liquidation, but its liquidators had continued to collect money from persons to whom money had been advanced and to repay money to persons from whom the taxpayer had borrowed money. The Commissioner for SARS had initially raised no objection to the liquidation and distribution accounts in which no provision had been made for tax on the post-liquidation income of the taxpayer. The Commissioner thereafter objected on the basis that the balance of assessed loss should not be offset against the taxpayer's post-liquidation income as it had not carried on trading after liquidation. The court held that if it were accepted that a liquidated company could continue to trade, then the facts regarding the operation of the taxpayer in each case becomes the determining factor. The court considered the issue of whether the taxpayer had a legitimate expectation, which was based upon an agreement reached between the parties. Furthermore, the court had to consider the Commissioner's conduct thereafter until he objected to the fourteenth liquidation and distribution account, which assumed that the taxpayer was entitled to offset its post-liquidation income against the assessed loss brought forward from the date of liquidation for each subsequent year. The court said that, although it was not necessary to decide the matter on the basis of legitimate expectation, it noted that the Commissioner was not entitled to simply change his mind, when there was no

²³² 65 SATC 294, 2002

factual justification for the change, by making assumptions that could not be sustained after a vigorous examination of the facts before a court.

9.6 CONCLUSION ON THE PRINCIPLE OF LEGITIMATE EXPECTATION.

The introduction of the principle of legitimate expectation into South African law by Justice Corbett was some four years prior to our new constitutional dispensation and is an important milestone in the development of the South African law. It highlights his understanding of the law and its international development and his foresight in respect of the application and implementation of legal principles.

Taxpayers now have more rights in respect of their ability to put forward representations or to be heard before SARS takes a major decision. “To be heard”, or the *audi alteram partem* principle, has always existed in South African law. The principle of justifiable expectation extends and gives greater meaning to the *audi alteram partem* principle in the sense that, in certain circumstances, a person’s right to be heard cannot be taken away by statutory means.

9.7 THE NEW CONSTITUTION

Whereas Justice Corbett’s formative approach was his attempt to determine and apply what Parliament wanted to accomplish by means of the Act, the

Constitution of the Republic of South Africa²³³ (“new Constitution”), provides a new perspective to the way in which judgements are given in the High Court and the Constitutional Court. The courts have to consider the effect on taxpayers’ rights.

Shortly after the new Constitution came into effect in 1996 (the 1996 Act embodies the principles of the 1993 Interim Constitution²³⁴), the validity of Acts, or parts thereof, were questioned in several court cases where allegations were made of the contravention of the Constitution. An Act is invalid if it is inconsistent with the Constitution²³⁵ and many Acts and sections of Acts have been repealed or amended to comply with the Constitution. The Constitution is supreme and no Act may contravene it²³⁶.

As mentioned in chapter 2, Chief Justice Corbett was instrumental in the initiation and implementation of the new Constitution. Unfortunately he retired before he had the chance to examine taxpayers’ rights in detail in the light of the new Constitution.

²³³ Act 108 of 1996

²³⁴ Act 200 of 1993

²³⁵ Section 2 of the Constitution.

²³⁶ According to the section 2 of the Constitution

9.7.1 **THE BILL OF RIGHTS AND ITS INFLUENCE ON TAXPAYERS' RIGHTS**²³⁷

Chapter 2, section 7 to 39, of the Constitution of the Republic of South Africa, Act 108 of 1996, includes a Bill of Rights. The rights contained in the chapter are of general application insofar as the state and the citizens are concerned. The Bill of Rights contains a comprehensive listing of rights that are protected under the Constitution and certain of these rights are applicable to tax administration. For example, section 9 of the Constitution, which deals with equality, holds that all persons are equal before the law and prohibits discrimination on various grounds. It is for this reason that South Africa now has a unitary tax rate for natural persons. The previous system of taxing married persons, unmarried persons and married woman at different rates is considered to be unconstitutional.

Section 14 of the Constitution deals with taxpayers' right to privacy, which includes the right not to have their homes searched or possessions seized. Before the adoption of the 1993 Interim Constitution, SARS could arrive unannounced at a taxpayer's premises and search and seize whatever records it deemed necessary, with only the signature of the Commissioner necessary to authorise the search, according to the rules laid down by the old section 74.

Section 74 of the Income Tax Act has now been repealed and replaced by a series of sections, namely sections 74A to 74D, which deal with the

²³⁷ An article "Your Rights as a Taxpayer" by B Croome in the SA Accountant of June 1999

procedures required to be followed before SARS may conduct a search of premises or seize documents. If SARS now wishes to conduct an investigation at a taxpayer's premises, it should approach a judge of the High Court to obtain a warrant that grants it the authority to search the premises and seize records.

The only other time that a SARS official may visit a business to examine records is when due and proper notice has been given in accordance with the Income Tax Act. SARS officials may therefore not arrive unannounced at a taxpayer's premises to conduct routine VAT, PAYE or other inspections, unless it has made prior and proper arrangements with the taxpayer.

9.7.2 Section 74(3) as it then was prior to amendment of the Income Tax Act (search and seizure provisions – possible contravention of the Constitution)

In *Rudolph and Another v Commissioner for Inland Revenue and Others*²³⁸, Justice Corbett had his only opportunity to examine a taxpayer's right to privacy and property in terms of the new Constitution. Unfortunately, being Chief Justice of South Africa rather than President of the Constitutional Court, meant that he had to refer all Constitutional issues raised in terms of the Interim Constitution, to the Constitutional Court²³⁹ for a decision. The new Constitution of 1996 now enables the High Court to give decisions on

²³⁸ [1996] 2 All SA 553(A), 58 SATC 183

²³⁹ According to section 103(2) of the Interim Constitution, Act No 200 of 1993

Constitutional issues²⁴⁰, which, if appealed, would be finally arbitrated by the Constitutional Court. In the *Rudolph* case a search and seizure of books, accounts and records took place in terms of section 74(3) of the Act. In the court *a quo*, the taxpayer contended that the search and seizure constituted an infringement of, or a threat to, his rights in terms of section 13 of the Interim Constitution.

On appeal, the issues before Justice Corbett in the Appellate Division were:

- whether the Appellate Division was competent to adjudicate and determine, on common law grounds, the validity in regard to the power to search that was granted to the Commissioner by the Act or
- whether these issues fell within the exclusive jurisdiction of the Constitutional Court and
- whether section 74(3) was inconsistent with Chapter 3 of the Constitution of the Republic of South Africa, Act 200 of 1993.

It was held that the Court did not have a parallel common law jurisdiction and, in any event, in order to decide whether the Court would have such a jurisdiction, it would be obliged to interpret the Constitution, which it was not entitled to do. Justice Corbett therefore referred the case to the Constitutional Court.

²⁴⁰ According to section 169 of the Constitution, Act No108 of 1996

9.8 CONCLUSION ON THE NEW CONSTITUTION

In 1993, Chief Justice Corbett accepted an invitation to “*play a prominent role in the transitional process*”. His acceptance was welcomed by Mr Mandela, the then leader of the ANC, and the then Democratic Party spokesman on justice, Mr Tony Leon.

Chief Justice Corbett played a major role in the drafting of the Constitution as well as the formation of the Constitutional Court. After a visit to the United States in 1976, he said that he had become a convert to a Bill of Rights, which has a power of review vested in the courts. In this regard he later commented that “*What I said at the time caused many an eyebrow to lift in governmental and judicial circles*”²⁴¹.” However, in the negotiations at CODESA it was accepted that a Bill of Rights should form an integral part of any new South African constitution.

The Constitution and particularly the Bill of Rights has had a major impact on legislation in South Africa. Several cases²⁴² have been heard in the

²⁴¹ *The Quest for Justice*, p. 40.

²⁴² *Rudolph and Another v CIR*, 1996, (4) SA 552 (CC), as discussed

Others include:

- *Metcash Trading Limited v CIR*, 2001, (1) BCLR 1 (CC) on the pay-now-argue-later principle as contained in section 36 of the Value Added Tax Act.

- *Motsepe v CIR*, 1997, (2) SA 898 (CC), on the proceedings when taxes are recovered. The constitutionality of the provisions of sections 92 and 94 of the Income

Constitutional court regarding sections of the Income Tax Act that were in contravention of the Constitution. Many amendments²⁴³ have been made to the Income Tax Act to meet the stringent requirements of the Constitution.

Tax Act was referred to the Constitutional Court. The taxpayer contended that sections 92 and 94 were inconsistent with the equality provisions, the access to court right and the right to administrative justice contained in sections 8(1), 22 and 24 of the Interim Constitution respectively. Section 92 and 94 of the Income Tax Act deems an assessment to be correct and unquestionable, except if an objection or appeal has been lodged.

The Constitutional Court observed that the referral was incompetent for the reason that the taxpayer had failed to exhaust her non-constitutional remedies of objection and appeal in terms of Part 3 of the Income Tax Act.

²⁴³ For example, South Africa now has a unitary tax rate for natural persons, as the previous system of taxing married persons, unmarried persons and married woman at different rates is considered to be unconstitutional in terms of equality.

CHAPTER 10 **REVIEW OF JUSTICE CORBETT'S CONTRIBUTION**
TO SOUTH AFRICAN TAX LAW

10.1 **INTRODUCTION**

Watermeyer CJ has been recognised as one of the judges who has made a substantial contribution to the development of the law in South Africa²⁴⁴. This was especially so in the field of the law of taxation. A review of the contents of chapters four to nine of this dissertation reveals that Justice Corbett continued this tradition and had a special interest in developing the law of taxation. Even some of his minority judgements have had impact on the development of tax law in South Africa. He was not afraid to disagree with his fellow judges when circumstances warranted it. Some of these minority judgements have been referred to in subsequent cases and in some instances the law was changed as a result of his minority judgement²⁴⁵

²⁴⁴ Watermeyer CJ gave judgements in the following landmark cases, to name but a few: *Lategan v Commissioner for Inland Revenue* 1926 CPD 203; *Commissioner for Inland Revenue v Lever Bros and Unilever* 1946 AD 441; *New State Areas Ltd v CIR* 1946 AD; *Port Elizabeth Electric Tramway Company v CIR*, 1936 CPD 241.

²⁴⁵ See part 7.2 on *SIR v Safranmark (Pty) Ltd* 43 SATC 235, 1982 (1) SA 113 (A)

10.2 A BRIEF EVALUATION OF JUSTICE CORBETT'S CONTRIBUTION TO SOUTH AFRICAN TAX LAW

How can Justice Corbett's contribution to the South African Tax Law be evaluated? Fortunately, in a speech delivered just before his retirement in 1993²⁴⁶, Justice Corbett gave his own version of what is expected of the members of the Supreme Court (now the High Court). He outlined the following expectations:

- knowledge and experience
- independence
- judgement
- character and industry.

Justice Corbett had all these attributes. It is clear that he had the knowledge and experience necessary for the position not only as a judge of the highest court of the land at the time, but also Chief Justice of South Africa. He was always up to date with international trends in the law and he often used the decisions of foreign courts to find an equitable solution to a South African problem.

As far as independence is concerned, he has been accused of being *pro-fiscus* - a charge which is not, it is submitted, sustainable. In any event, even if the charge of being *pro-fiscus* was warranted, it did not mean that he was not independent. A statistical review of his decisions and the number of times that

²⁴⁶ 1993 De Rebus issue 959 at 962-3; see Chapter 1

he decided in favour of the Commissioner cannot be used to support this accusation²⁴⁷.

The clarity of his judgements have been acknowledged and acclaimed by the judiciary and academics alike and the fair and equitable way in which he treated litigants, from criminals to innocent taxpayers is a revelation. Where criticism was necessary, he was not afraid to dish it out to government officials, including the Revenue Authorities, and to the various litigants.

Justice Corbett had the impeccable birth credentials to become a famous judge and contribute substantially to the development of the law in South Africa. This was particularly so in tax matters.²⁴⁸

10.3 KNOWLEDGE AND EXPERIENCE TO INTERPRET TAX LAW

Justice Corbett served on many panels for income tax cases heard in the Appellate Division (now referred to as the High Court of Appeal). His judgements created a precedent for subsequent cases of a similar nature.

On occasion, the Income Tax Act appears to be vague and general. This is probably unavoidable in many instances as it applies to all sectors of the economy. The main reason for tax cases being brought before a court is a difference of opinion regarding the interpretation of one or more of the sections of the Income Tax Act and needs clarification by the court. In this

²⁴⁷ See part 1.6

²⁴⁸ Refer chapter 2.

respect, case law plays a major role in interpreting the Income Tax Act. It is important that the decision in one case does not conflict with the decision in another case, because such conflicting interpretations cause confusion for both the taxpayers and the tax authorities. In most instances, however, some reason is given in a judgement as to why a particular line of thought of a previous decision is not followed in a later case. Conflicting decisions arise mostly because

- a. the case was blatantly incorrectly decided
- b. the case was not correctly argued by the taxpayer or the Commissioner
- c. the taxpayer failed to discharge the onus placed upon him by section 82.

Thus, many decisions, thought to be in conflict, are not actually in conflict.

A typical example of a case in which the interpretation of a section of the Act is required, would be to establish whether a particular taxpayer could be classified as a “manufacturer” in order to qualify for certain incentives that are applicable to manufacturers. Such an interpretation was required in *Safranmark*²⁴⁹, in which Justice Corbett, in his dissenting judgement, gave an excellent interpretation of the meaning of the word “manufacturing”. The purpose of his judgement was to convey the normal meaning of the word that had been included in the Act. He did not attempt to second guess what Parliament’s motives were with the introduction of that section of the Act. He

²⁴⁹SIR v Safranmark (Pty) Ltd, 43 SATC 235

gave an independent point of view that was based on his (substantial) knowledge of the interpretation of section 12. It was not the duty of the court to criticize the Act or particular sections of the Act. His interpretation, it is submitted, gives an accurate definition of the normal meaning of the word “manufacture”. He left it to the legislature to amend the section to include a wider meaning to the section, which they later did. The majority of the panel concerned, however, understood the intention of the legislature in their interpretation of the section, but their interpretation was not particularly accurate in that it stretched the meaning of “manufacturing”. Even the layman would, it is submitted, find difficulty in acknowledging that cooking chicken is regarded as a manufacturing process.

It is ironical that in the *Automated Business Systems* case²⁵⁰, the court followed a narrow interpretation of the meaning of “manufacture” in spite of the fact that all the essential elements regarded as necessary for the process involved to be classified as a manufacturing process, were present. The automated process of clearing bank cheques was held not to be a process of manufacture. It is submitted that this was a correct decision by the court but was not in accordance with the majority decision in the *Safranmark* case.

In his dissenting judgement in *Safranmark (supra)*, Justice Corbett had said:

“When deciding whether a particular activity does or does not fall within the ambit of a ‘process of manufacture’ the ordinary, natural

²⁵⁰ 1986 (2) SA 645(T), 48 SATC 41

meaning of that phrase in the English language must not be lost sight of.”

Where sections are vague, outdated or incomplete, the judgements that are delivered may cause amendments to be made to the Act. A major change to a leading section of the Act was the amendment of section 23(g) to exclude the wording “wholly and exclusively”. This amendment occurred shortly after the judgement was delivered in the *Solaglass* case²⁵¹. The judgement dealt with the strict application of section 23(g). The court in that case did not apply apportionment of expenses incurred partly for trade and partly non-trade purposes. When the changes to section 23(g) were instigated, the legislature relied heavily on the judgements of Justice Corbett in *Nemojim*²⁵², *Pick n Pay*²⁵³ and *De Beers*²⁵⁴, which, together with *Rand Selections*²⁵⁵, are the major apportionment cases in South African tax law.

Justice Corbett decided on the apportionment of expenses in the *Nemojim’s* (*supra*) case, even though the Act ostensibly excluded apportionment at that time, or at the very least was silent on the matter. Inland Revenue noted this decision and the “wholly and exclusively” provision in section 23(g) was amended as a result of the very narrow interpretation given in the *Solaglass* (*supra*) case, a case in which Justice Corbett was involved.

²⁵¹ *Solaglass Finance Company (Pty) Ltd v CIR*, 1991 (2) SA 257 (A), 53 SATC 1.

²⁵² *CIR v Nemojim (Pty) Ltd*, 45 SATC 241

²⁵³ *CIR v Pick ‘n Pay Wholesalers (Pty) Ltd*, 49 SATC 132

²⁵⁴ *De Beers Holdings (Pty) Ltd v CIR*, 47 SATC 229

²⁵⁵ *CIR v Rand Selections Corporation Ltd*, 20 SATC 390

Justice Corbett had an excellent ability to analyse and evaluate the facts of a case and to apply the letter of the Act to each case. The decision that he made in *Gallagher*²⁵⁶ was instrumental in the amendment of section 103(1) to include the avoidance of “estate duty” as a tax included within the ambit of section 103(1). Before the amendment was promulgated, only income tax avoidance could trigger an attack from the Commissioner in terms of section 103(1).

It is not the duty of a judge to make law. It is up to Parliament to pass legislation and the courts to interpret such legislation.

In *Nemojim (supra)*, Justice Corbett stated that “*there is no equity about a tax*”. He added, however, that

“...there is nevertheless a measure of satisfaction to be gained from a result which seems equitable, both from the point of view of the taxpayer and from the point of view of the fiscus.”

Judge Corbett’s findings in *Edgars*²⁵⁷ and *Golden Dumps*²⁵⁸ provided greater clarity on the interpretation of the general deduction formula. He found that in order to fulfil the requirements of “actually incurred” and “during the year”, in accordance with section 11(a), it is necessary that a claim for a deduction should have been finalised in the same fiscal year. This requirement also

²⁵⁶ *SIR v Gallagher*, 40 SATC 39

²⁵⁷ *Edgars Stores Ltd v CIR*, 50 SATC 81

²⁵⁸ *CIR v Golden Dumps (Pty) Ltd*, 55 SATC 198

applies in the United Kingdom. In *Herbert Smith v Honour (supra)*, the rentals were fixed in a lease contract and the amount payable had therefore been established. It is clear that Justice Corbett did not deviate from the international trend. *Edgars Stores* and *Golden Dumps (supra)* have been cited and applied as reliable references in South African tax law although the *Edgars Stores* case does create some problems²⁵⁹.

In *Berea West*²⁶⁰ and *JM Malone*²⁶¹, Justice Corbett approved the use of a realisation company and a trust for the purpose of preserving the capital nature of the proceeds on realisation. However, this method of realisation has had limited use since the introduction of Capital Gains Tax in 2001. Paragraph 12(2)(c) of the Eighth Schedule to the Act provides for the valuation of property when there is a change in the intention of the holding it as an asset. This means that a revenue profit on the sale of an asset will only be realised after the asset was re-valued at the time of the change of intention. Current legislation does not have the “all or nothing” effect, as occurred in the case in *Berea West (supra)*.

10.4 INDEPENDENCE OF THE COURT

As already mentioned, a judge does not make law, he interprets law. Similarly, the Commissioner may not apply practices that are not sanctioned

²⁵⁹ See paragraph 6.6

²⁶⁰ *Berea West Estates v SIR*, 38 SATC 43

²⁶¹ *JM Malone Trust v SIR*, 39 SATC 83

by the Act. The reality is that the tax laws are essential elements in ensuring that the government has the funds that it requires to provide the services that fulfil the needs of the population of the country. In this regard, it is possible that the judiciary might lean towards supporting the government in its quest to obtain as much tax as possible at the expense of the taxpayer, which is the *pro fiscus* approach. Nevertheless, the judiciary have a duty to act independently. The judiciary certainly do not condone all the actions of the Commissioner in the collection of taxes. Taxpayers are able to submit their interpretation of the Act to the Court for proper and neutral consideration.

In South Africa, a tax case does not depend on the judgement of a single judge. The Special Tax Court, as provided for in section 83 of the Act, requires that three persons should serve on the Board, including at least one judge. In the High Court of Appeal there has never been less than three judges on the panel in any one tax case. At present five judges serve on the panel. The use of an uneven numbers of judges is to ensure that a majority outcome is achieved in each case. This arrangement ensures a fair degree of independence and neutrality. It also ensures a large measure of competence as a result of the combined knowledge and experience of the greater number of judges.

Justice Corbett delivered judgements in eighteen tax cases in the Appellate Division. Ten judgements were delivered in favour of the taxpayer, the remainder in favour of the Commissioner.

These statistics appear to indicate a fair degree of neutrality by him (and the court), albeit with perhaps a slight favouring of the taxpayer. However, in the

cases of *De Beers* and *Pick 'n Pay Wholesalers (supra)*, Justice Corbett appeared to be *pro-fiscus*. This also occurred in his minority judgement in *Safranmark*, whilst in *Gallagher* and his minority judgement in *Elandsheuwel (supra)*, his formative approach favoured the taxpayer. In *Pick 'n Pay (supra)*, his decision not to apportion expenses was in favour of the Commissioner, but in *Standard Bank*²⁶² his decision was against the Commissioner.

The major case on which the perception of Mr Justice Corbett's *pro-fiscus* approach has been based, is *De Beers Holdings (supra)*. Corbett JA (as he then was) held that the taxpayer had not entered into a normal share-dealing transaction. The scheme was not entered into with the intention of making a profit, but in the contemplation of registering a loss and ultimately obtaining a substantial tax deduction. In short, Justice Corbett extended the limitation of a tax deduction in terms of section 23(g) by equating trade with profit. In this manner he was able to examine the substance of the transaction, that is, the exploitation of certain loopholes in the Act to construct a tax loss. Commentators have suggested that in this case the Appellate Division had followed the recent jurisprudence practice in England where the courts had favoured a substance over form approach. As one commentator argued:

*“...in order to achieve his disallowances... he has... had to ride roughshod over the trading stock provisions of the Act in order to achieve so-called equity.”*²⁶³

²⁶² CIR v Standard Bank of SA Ltd, 47 SATC 179

²⁶³ “The Appellate Division and Equity in Taxation” an essay by T Emslie in the Income Tax Reporter, No. 26 (1987) at p51.

In *De Beers Holdings* Justice Corbett used the substance over form approach which contrasted with his usual formative approach.

10.5 SUBSTANCE OVER FORM

The taxpayer has the right to arrange his financial affairs in a suitable manner so as to minimise his tax liability. Such tax planning or tax avoidance activity is certainly not illegal. The Commissioner finds it difficult to combat these actions within the framework of the Act. Creative taxpayers constantly target loopholes in the Act and the courts are the last resort for the *fiscus* to combat existing tax-avoidance schemes until amendments are made to the tax legislation. Because the Commissioner cannot attack an avoidance scheme in terms of section 103 in all instances, the court is obliged to choose between the “purposive” approach (substance) and the “formative” approach (form) in interpreting legislation.²⁶⁴

Justice Corbett’s formative approach was evident in *Elandsheuwel*. The section 103 cases of *Gallagher*, *Louw* and *Burgess* confirmed his formative approach to the legislation and the facts of the case. The fact that he was

²⁶⁴ Section 39 of the Constitution appears to advocate a purposive interpretation of Acts in terms of the fundamental values of the Constitution. Sub-section 2 reads: *When interpreting any legislation, and when developing the common law or customary law, every court, tribunal or forum must promote the spirit, purport and objects of the Bill of Rights.*

formative does not imply that he overlooked the substance of the matter. When applying section 103 to tax avoidance, he used a formative approach. In other avoidance cases, such as *Nemojim* and *De Beers*, he did not use the formative approach, but used the substance approach instead. The substance over form approach may favour the Commissioner.

An analysis of the judgement in *De Beers Holdings* reveals that the court applied the provisions of section 23(g) to disallow a substantial deduction, which had clearly been the major objective of the transaction. The only possible criticism of the judgement could be that the court equated the word “trade” with “profit” so that the taxpayer’s lack of a profit motive meant that it was not trading and hence could not claim a deduction. In itself, this approach to the section can hardly be equated with the substance over form approach to the interpretation of tax legislation that was adopted in certain English cases.

Even the substance over form approach cannot stop taxpayers from making “paper losses”, a term that Justice Corbett used in the *De Beers* case. The tax authorities cannot disallow losses purely on the grounds that the taxpayer never had a realistic possibility of making a profit. Legislation has recently been changed to ring-fence losses that may be incurred in tax-avoidance schemes²⁶⁵.

²⁶⁵ Section 20A – Ring-fencing of assessed losses; with effect from 2005 tax year.

Justice Corbett delivered judgements that have made a significant impact on South African tax law, especially the judgements in *Elandsheuwel* and *Louw*. In addition, he served on the panel of judges that delivered the judgement in *Burgess*. According to Justice Dennis Davis²⁶⁶ South African courts should be cautious in following a purposive approach to tax law. This was the strategy that Justice Corbett followed in the *Gallagher* case, namely a formative approach in applying the rules of section 103(1) of the Act as they were then understood. The important cases that have been discussed reveal that Mr Justice Corbett's record admirably reflects such caution.

It should be noted that the courts have moved away from the purely rigid and formative approach that was evident in Justice Corbett's earlier cases and legislation has been introduced in section 103(1) to sanction such movement²⁶⁷. Instead, both the substance and the legal format of each case are noted and considered before judgement is given. The legal format of a case can never be ignored, but the underlying economic reality of a case should also be evaluated. It is submitted that Justice Corbett ignored the economic incentive of granting capital allowances to taxpayers in his dissenting judgement in the *Safranmark* case (substance) and concentrated instead on the clear and unambiguous wording of the section in the Act (form).

²⁶⁶ An essay by D M Davis on Substance over form in tax law: The contribution of Mr Justice Corbett. *The Quest for Justice*, p. 151.

²⁶⁷ The *bona fide* business purpose test

10.6 INTERNATIONAL JURISPRUDENCE

It is clear that Justice Corbett consulted case law of other countries before he delivered judgements. In most of his judgements he referred to foreign cases, especially to the tax reports of the United Kingdom. This referral is evident in the *Pick 'n Pay* case (*supra*). In this case, Justice Corbett opted for the “dual purpose” principle, which is an established part of the tax law in the United Kingdom. It implies that if an expense is incurred with mixed motives, then it is not deductible, unless the main motive can be proved. This was the state of affairs under the old wording of section 23(g) which only allowed expenses that were “wholly and exclusively” incurred for the purposes of trade.

Although no reference is made to the fact, it was known that donations to charitable organisations were never allowed as a general deduction in Australia, New Zealand and the United Kingdom. This fact ultimately prevented the courts in South Africa from allowing this expense as a deduction. Having been a scholar at Cambridge, Justice Corbett was exposed to a wider legal background than was possible only in South Africa. His training background at Cambridge gave him some insight into the legal system of the Commonwealth, as well as personal contact with persons in the legal field in the Commonwealth. On the other hand, his dissenting judgements in *Safranmark* and *Elandsheuwel* (*supra*) did appear to be at variance with international thought and case law.

The introduction of the principle of legitimate expectation by Justice Corbett²⁶⁸ was an important milestone in the development of the South African law. It highlights his understanding of the law and its international development and his foresight in respect of the application and implementation of legal principles. This principle is embodied in our new Constitution.

Taxpayers now have more rights in respect of their ability to put forward representations or to be heard before SARS takes a major decision. “To be heard”, or the *audi alteram partem* principle, has always existed in South African law. The principle of justifiable expectation extends and gives greater meaning to the *audi alteram partem* principle in the sense that, in certain circumstances, a person’s right to be heard and considered cannot be taken away by statutory means. The principle of legitimate expectation is applicable to decisions by officials in Alternative Dispute Resolutions²⁶⁹, Settlement Disputes²⁷⁰ and Advanced Rulings situations.

The principle of legitimate expectation specifically targets the relationship between the government and the citizen. This principle has been applied in several court cases, which illustrates the value of Justice Corbett’s foresight in introducing it into South African law.

²⁶⁸ Administrator, Transvaal and Others v Traub and Others, 1989, (4) SA 731 (A)

²⁶⁹ Section 107A of the Act

²⁷⁰ Section 88A of the Act

10.7 THE CONSTITUTION²⁷¹

Justice Corbett's greatest legacy is probably that he was one of the main proponents of a Bill of Human Rights and its incorporation in the Constitution of South Africa. Chief Justice Corbett played a major role in the drafting of the Constitution as well as in the formation of the Constitutional Court. After a visit to the United States in 1976, he said that he had become a convert to a Bill of Rights, with a power of review vested in the courts. He stated the following in this regard: "*What I said at the time caused many an eyebrow to lift in governmental and judicial circles*"²⁷²." However, during the negotiations at CODESA it was accepted that a Bill of Rights should form an integral part of any new South African constitution.

Chapter 2 of the Constitution of the Republic of South Africa, Act 108 of 1996, contains a Bill of Rights. The rights contained in the chapter are of general application insofar as the state and citizens are concerned. Many of the rights do, however, apply to tax administration and to how the South African Revenue Service conducts itself in dealing with the South African taxpayer.

The Constitution and particularly the Bill of Rights had a major impact on legislation in South Africa. Several cases were heard in the Constitutional court regarding sections of the Income Tax Act that were in contravention of the Constitution. Many amendments were made to the Income Tax Act to meet the terms of the Constitution.

²⁷¹ "Your Rights as a Taxpayer", Accountancy South Africa, June 1999 by B. Croome

²⁷² *The Quest for Justice* at page 40

Unfortunately, however, Justice Corbett never had the opportunity to pronounce on Constitutional issues in general and taxpayer's rights in particular, since he retired in 1993, shortly after the Interim Constitution came into force. The only time he was faced with a Constitutional issue after the promulgation of the Interim Constitution, he had to refer the matter to the Constitutional Court, a court to which he was not appointed as a member.

10.8 FINAL WORDS ON JUSTICE CORBETT'S CONTRIBUTION TO THE DEVELOPMENT OF THE LAW OF TAXATION IN SOUTH AFRICA

Justice Corbett had a long and illustrious career. It is a daunting task to be a judge in the Supreme Court who must deal justly with the opposing viewpoints of the plaintiff and the defendant. All his judgements were valuable contributions to the South African tax law.

All his judgements, including his dissenting judgements, were cited and applied, if applicable, in subsequent cases as being valid references. Some of his decisions although convincing, were not accepted as part of our law, such as his minority judgements in *Elandsheuwel* and *Safranmark*, as well as his view on the deductibility of expenses in the *De Beers* case, if the transactions did not have a profit motive. These views were overturned in subsequent cases.

Some judgements led to changes being made in the prevailing legislation. His decisions to apportion expenses as well as income received, played a major role in the development of tax law in South Africa although his decision when to apply or when not to apply the apportionment rule were criticised²⁷³. Section 22 relating to the definition of trading stock, had to be amended directly as a result of his decision in the *De Beers* case.

Justice Corbett will be remembered, *inter alia*, for his formative approach to section 103(1), the introduction of the legitimate expectation principle to South Africa and, finally his part in the drafting of the new Constitution.

To repeat the words of Lord Steyn²⁷⁴ in his tribute to Justice Corbett:

“Taking qualities of judicial temperament for granted, it seems to me that the tribute of greatness must be reserved for judges who satisfy five requirements which overlap to some extent. First there is style and theme. Then, critical faculties and powers of legal analysis. Profound knowledge of the law. A great judge must have a coherent philosophy of the role of the courts of law as an arm of government in a broad sense. He must also develop the law in a principled manner. Michael Corbett has in my view displayed all the qualities which I have described.”

²⁷³ His judgement in the *Pick n Pay* case was criticised for not apportioning the expense between deductible and non-deductible portions, see chapter 6.5.

²⁷⁴ *The Quest for Justice*, p. 115, *Tribute to a Great Judge*, An essay by Lord Steyn, PC BA LLB (Stell) MA (Oxon), Bencher of Lincoln’s Inn, Lord of Appeal in Ordinary, Great Britain.

4. Kahn, Ellison *Fiat Iustus* - Essays in Memory of Oliver Schreiner, Juta & Co, Johannesburg, (1983)

5. Hetherington, Stephen Simon's Tax Cases, Butterworths Lexis Nexis, Widdicombe, Karen London, 2001

6. Bix, Brian Jurisprudence: Theory and Context, Second Edition, Westview Press, London, 1999

7. Vorster, Henry The Parameters of Tax Planning, Witwatersrand University, Johannesburg, 1984.

8. Mervyn Lewis Butterworths' British Tax Law

PUBLICATIONS ON CD ROM

9. Butterworths' Complete Tax Library on South African Tax Law, South African Tax Cases and Silke on South African Income Tax. Update: 2006

10. Butterworths' Complete Tax Library on New Zealand Tax Law. Update 2006.

WEBSITES

11. Australian Revenue Office (www.ato.gov.au). Access Date: 30 June 2006

12. South African Revenue Service (www.sars.gov.za). Access Date: 30 June 2006

13. Not the SA Revenue Service, an unofficial site (www.ftomasek.com/notsars). Access Date: 30 June 2006

14. New Zealand Inland Revenue (www.ird.govt.nz). Access Date: 30 June 2006

15. United Kingdom Inland Revenue (www.inlandrevenue.gov.za).

Access Date: 30 June 2006

16. Moneyweb (www.moneyweb.co.za). Access Date: 30 June 2006

ARTICLES

17. Croome, Beric “Your Rights as a Taxpayer”, Accountancy South Africa, June 1999

18. Croome, Beric “Taxpayer’s rights”, Accountancy South Africa, February 2001

19. Williams, R C “Simulated tax avoidance agreements holds no water”, Synopsis, Price Waterhouse Coopers, April 2004

APPENDIX A:
TAX CASES IN WHICH JUSTICE CORBETT WAS INVOLVED

Mr Justice Corbett served on the panel of judges in the following Appellate Division cases. The cases where he delivered a judgement are underlined. His minority judgements are highlighted:

African Detinning Works (Pty) Ltd v SIR	44 SATC 1
Berea West Estates v SIR	38 SATC 43
<u>Blue Circle Cement Ltd v CIR</u>	<u>46 SATC 21</u>
Bozzone and others v SIR	37 SATC 262
Brodie and Another v SIR	36 SATC 159
Buglar's Post (Pty) Ltd v SIR	36 SATC 71
Burgess v CIR	55 SATC 185
Caltex Oil (SA) Ltd v SIR	37 SATC 1
Chairman, Board on Tariffs and Trade and Others v Teltron (Pty) Ltd	59 SATC 363
Chancellor, Master and Scholars of the University of Oxford v CIR	58 SATC 45
Charles Velkes Mail Order 1973 (Pty) Ltd v CIR	49 SATC 109
CIR v Bowman	52 SATC 69
CIR v Brollo Properties (Pty) Ltd	56 SATC 47
CIR v Collins	54 SATC 371
CIR v D & N Promotions (Pty) Ltd	57 SATC 178
CIR v Da Costa	47 SATC 87
CIR v Dunlop South Africa Ltd	49 SATC 51

CIR v Estate Late Hulett	52 SATC 109
<u>CIR v Felix Schuh SA (Pty) Ltd</u>	<u>56 SATC 57</u>
CIR v First National Industrial Bank Ltd	52 SATC 224
<u>CIR v Golden Dumps (Pty) Ltd</u>	<u>55 SATC 198</u>
CIR v Guardian Assurance Company South Africa Ltd	53 SATC 129
CIR v Kuttel	54 SATC 298
CIR v Law Society, Transvaal	53 SATC 399
<u>CIR v Louw</u>	<u>45 SATC 113</u>
CIR v NCR Corporation of Southern Africa (Pty) Ltd	50 SATC 9
CIR v Nedbank Ltd	48 SATC 73
<u>CIR v Nemojim (Pty) Ltd</u>	<u>45 SATC 241</u>
CIR v Nussbaum	58 SATC 283
CIR v Ocean Manufacturing Ltd	52 SATC 151
CIR v People's Stores (Walvis Bay) (Pty)Ltd	52 SATC 9
<u>CIR v Pick 'n Pay Wholesalers (Pty) Ltd</u>	<u>49 SATC 132</u>
CIR v Pretorius	47 SATC 285
CIR v SA Mutual Unit Trust Management Company Ltd	52 SATC 205
CIR v Shell Southern Africa Pension Fund	46 SATC 1
CIR v Southern Life Association Ltd	48 SATC 191
<u>CIR v Standard Bank of SA Ltd</u>	<u>47 SATC 179</u>
CIR v Wandrag Asbestos (Pty) Ltd	57 SATC 123
Constantia Heights v SIR	41 SATC 77
<u>De Beers Holdings (Pty) Ltd v CIR</u>	<u>47 SATC 229</u>
<u>Edgars Stores Ltd v CIR</u>	<u>50 SATC 81</u>
<u>Elandsheuwel Farming (Edms) Bpk v SIR</u>	<u>39 SATC 163</u>
<u>Essential Sterolin Products (Pty) Ltd v CIR</u>	<u>55 SATC 357</u>
Estate Dempers v SIR	39 SATC 95

Gerber v CIR	51 SATC 183
Glen Anil Development Corporation Ltd SIR	37 SATC 319
Hilda Holt Will Trust v CIR	55 SATC 1
<u>JM Malone Trust v SIR</u>	<u>39 SATC 83</u>
Malan v CIR	45 SATC 59
Matla Coal Ltd v CIR	48 SATC 223
Nasionale Pers Bpk v CIR	48 SATC 55
Natal Estates Ltd v SIR	37 SATC 193
National Co-operative Diaries Ltd v CIR	54 SATC 1
Ovation Recording Studios (Pty) Ltd v CIR	52 SATC 163
Ovenstone v SIR	42 SATC 55
Plobar Estates (Pty) Ltd v CIR	47 SATC 98
R Koster and Son (Pty) Ltd v CIR	47 SATC 23
Rand Mines (Mining & Services) Ltd v CIR	59 SATC 85
Richards Bay Iron and Titanium (Pty)Ltd and Another v CIR	58 SATC 55
<u>Rudolph and Another v CIR</u>	<u>58 SATC 183</u>
Sentra-Oes Ko-operatief Bpk v KBI	57 SATC 109
SIR v Aveling	40 SATC 1
SIR v Connan	36 SATC 87
<u>SIR v Downing</u>	<u>37 SATC 249</u>
SIR v Eaton Hall (Pty) Ltd	37 SATC 343
<u>SIR v Gallagher</u>	<u>40 SATC 39</u>
SIR v Geustyn, Forsyth and Joubert	33 SATC 113
SIR v Guardian assurance Holdings (SA) Ltd	38 SATC 83
SIR v Olifantsrivierse Ko-operatiewe Wynkelders Bpk	38 SATC 79
<u>SIR v Rile Investments (Pty) Ltd</u>	<u>40 SATC 135</u>

<u>SIR v Safranmark (Pty) Ltd</u>	<u>43 SATC 235</u>
SIR v Sidley	39 SATC 153
SIR v Trow	43 SATC 189
Stone v SIR	36 SATC 117
Taeuber and Corsen (Pty) Ltd v SIR	37 SATC 129
Tieber v CIR	55 SATC 10
<u>Tuck v CIR</u>	<u>50 SATC 98</u>
Warren Marine (Pty) Ltd v SIR	44 SATC 69
Werklike Aantreklike Beleggings (Edms) Bpk v KBI	50 SATC 47

APPENDIX B

Supplement from Butterworth's Books on Screen (on CD)

Justice Corbett's judgments were cited as follows:

SIR v Downing 37 SATC 249

referred

1 ITC 1544 (1992) 54 SATC 456 (T) at 460

Elandsheuwel Farming (Edms) Bpk v SBI 39 SATC 163, 1978 (1) SA 101 (A)

referred

SIR v Rile Investments (Pty) Ltd 40 SATC 135 at 141 & 152, 1978 (3) SA 732 (A)

ITC 1278 (1978) 40 SATC 210 (R) at 212

referred & applied

Greenband Properties (Pty) Ltd v CIR 43 SATC 151 at 155, 156 & 157, 1981 (C)

referred

CIR v Modified Investments (Pty) Ltd 43 SATC 257 at 263, 1982 (1) SA 331 (T)

ITC 1344 (1981) 44 SATC 19 (C) at 19

ITC 1348 (1981) 44 SATC 46 (EC) at 47

cited

ITC 1355 (1981) 44 SATC 132 (C) at 138

cited & referred

ITC 1379 (1983) 45 SATC 236 (C) at 237 & 238

referred

ITC 1388 (1983) 46 SATC 126 (EC) at 136

referred & distinguished

ITC 1406 (1985) 48 SATC 12 (T) at 14 & 16

cited

Werklik-Aantreklik Beleggings (Edms) Bpk v KBI 48 SATC 112 at 130, 1986 (O)

referred

ITC 1413 (1985) 48 SATC 167 (C) at 171

cited & applied

ITC 1418 (1986) 49 SATC 42 (C) at 44

referred

CIR v Pick 'n Pay Wholesalers (Pty) Ltd 49 SATC 132 at 154, 1987 (3) SA 453 (A)

cited & referred

ITC 1427 (1987) 50 SATC 25 (T) at 31 & 33

referred

ITC 1431 (1986) 50 SATC 60 (T) at 67

cited

CIR v Gribnitz 50 SATC 127 at 130, 1988 (T)

referred

ITC 1462 (1988) 51 SATC 168 (U) at 171

CIR v Malcomess Properties (Isando) (Pty) Ltd 53 SATC 153 at 164, 1991 (2) SA
27(A)

ITC 1494 (1990) 53 SATC 206 (EC) at 213

ITC 1498 (1989) 53 SATC 260 (E) at 265

referred & cited

ITC 1509 (1990) 54 SATC 18 (EC) at 25-67

referred

ITC 1522 (1989) 54 SATC 185 (C) at 189

ITC 1526 (1991) 54 SATC 216 (T) at 223

referred & cited

54 SATC 271 at 279, 290 & 293, 1992 (A)

ITC 1541 (1991) 54 SATC 408 (T) at 413-14

ITC 1543 (1992) 54 SATC 446 (C) at 448-9 & 454

ITC 1560 (1990) 55 SATC 294 (EC) at 300-1

referred

Berea Park Avenue Properties (Pty) Ltd v CIR 57 SATC 167 at 171, 1995 (2) SA

411(A)

ITC 1597 (1993) 58 SATC 27 (T) at 33

Erf 3183/1 Ladysmith (Pty) Ltd and Another v CIR 58 SATC 229 at 238, 1996 (A)

CIR v Nussbaum 58 SATC 283 at 290, 1996 (A)

referred & cited

ITC 1608 (1993) 59 SATC 63 (T) at 67

CIR v Nel 59 SATC 349 at 354-5, [1997] 4 All SA 310 (T)

referred

ITC 1636 (1997) 60 SATC 267 (EC) at 303

ITC 1638 (1995) 60 SATC 423 (C) at 427

referred & cited

ITC 1639 (1997) 60 SATC 430 (EC) at 433 & 436

CSARS v Knuth Industrial Mouldings (Pty) Ltd 62 SATC 65 at 70-3, 1999 (E)

ITC 1659 (1998) 61 SATC 239 (E) at 242, 244-5 & 247

ITC 1672 (1998) 62 SATC 47 (G) at 59

ITC 1680 (1999) 62 SATC 355 (E) at 358 & 360

CSARS v Volkswagen of SA (Pty) Ltd 63 SATC 109 at 111, 2000 (SCA)

ITC 1719 (2001) 64 SATC 73 (SEC) at 75

referred

CSARS v Heron Heights CC 64 SATC 433 at 437, 2002 (EC)

SIR v Rile Investments (Pty) Ltd 40 SATC 135, 1978 (3) SA 732 (A)

referred

Constantia Heights (Pty) Ltd v SIR 41 SATC 77 at 91, 1979 (3) SA 768 (A)

SAM v COT 42 SATC 1 at 6, 1980 (2) SA 75 (ZR)

Ropty (Edms) Bpk v SBI 43 SATC 141 at 148, 1981 (A)

Greenband Properties (Pty) Ltd v CIR 43 SATC 151 at 156 & 157, 1981 (C)

CIR v Modified Investments (Pty) Ltd 43 SATC 257 at 262-63, 1982 (1) SA 331 (T)

cited

ITC 1406 (1985) 48 SATC 12 (T) at 14

ITC 1431 (1986) 50 SATC 60 (T) at 66

referred & cited

CIR v Malcomess Properties (Isando) (Pty) Ltd 53 SATC 153 at 164, 1991 (2) SA

27(A)

referred

ITC 1510 (1989) 54 SATC 30 (Z) at 36

referred & cited

ITC 1522 (1989) 54 SATC 185 (C) at 189

ITC 1541 (1991) 54 SATC 408 (T) at 413-14

referred

ITC 1639 (1997) 60 SATC 430 (EC) at 441

SIR v Gallagher 40 SATC 39, 1978 (2) SA 463 (A)

referred & discussed

Hicklin v SIR 41 SATC 179 at 185 & 191-93, 1980 (1) SA 481 (A)

cited

ITC 1348 (1981) 44 SATC 46 (EC) at 49

referred

COT v AB Company Ltd 45 SATC 78 at 83, 1982 (BCA)

CIR v Louw 45 SATC 113 at 139, 1983 (3) SA 551 (A)

cited & referred

ITC 1388 (1983) 46 SATC 126 (EC) at 132 & 135

referred

Plobar Estates (Pty) Ltd v CIR 47 SATC 98 at 101, 1985 (A)

ITC 1518 (1989) 54 SATC 113 (T) at 135

ITC 1606 (1995) 58 SATC 328 (C) at 335-6

ITC 1518 (1989) 54 SATC 113 (T) at 135

ITC 1606 (1995) 58 SATC 328 (C) at 335-6

referred & cited

ITC 1635 (1997) 60 SATC 260 (O) at 265

referred

ITC 1636 (1997) 60 SATC 267 (EC) at 318 & 334

ITC 1638 (1995) 60 SATC 423 (C) at 429

ITC 1639 (1997) 60 SATC 430 (EC) at 438

referred & cited

CSARS v Knuth and Industrial Mouldings (Pty) Ltd 62 SATC 65 at 74-5, 1999 (E)

KSAI v Botha 62 SATC 264 at 273, 2000 (1) SA 908 (O)

ITC 1684 (1998) 62 SATC 413 (E) at 422

referred

Weybro Boerdery BK v KBI 62 SATC 464 at 470, 1996 (T)

ITC 1699 (1999) 63 SATC 175 (C) at 180

ITC 1714 (1996) 63 SATC 507 (G) at 513

SIR v Safranmark (Pty) Ltd 43 SATC 235, 1982 (1) SA 113 (A)

referred & cited

Automated Business Systems (Pty) Ltd v CIR 48 SATC 41 at 45-8, 1986 (2) SA
645(T)

ITC 1445 51 SATC 40 at 44 & 45

cited

ITC 1449 51 SATC 65 at 68

referred, cited & applied

CIR v Stellenbosch Farmers' Winery Ltd, 51 SATC 81 at 86, 87 and 88, 1988 (C)

cited & applied; referred & distinguished

ITC 1465 (1989) 52 SATC 1 (C) at 3-4 and 6

referred & cited

Ovation Recording Studios (Pty) Ltd v CIR 52 SATC 163 at 172, 175 & 176, 1990

(3)SA 682 (A)

ITC 1479 (1989) 52 SATC 264 (T) at 271-2

Formscaff Investments (Pty) Ltd v CIR 55 SATC 251 at 255, 256 & 258, 1993 (4)

SA76 (T)

ITC 1559 (1989) 55 SATC 286 (C) at 290 & 293

referred, discussed & cited

ITC 1575 (1989) 56 SATC 203 (T) at 211-12

referred

ITC 1591 (1993) 57 SATC 212 (O) at 220

CIR v Nemojim (Pty) Ltd 45 SATC 241, 1983 (4) SA 935 (A)

referred, discussed, cited & applied

CIR v De Beers Holdings (Pty) Ltd 46 SATC 47 at 53-7, 1984 (3) SA 286 (T)

referred

CIR v Standard Bank of SA Ltd 47 SATC 179 at 194, 1985 (4) SA 485 (A)

De Beers Holdings (Pty) Ltd v CIR 47 SATC 229 at 252-57, 1986 (1) SA 8 (A)

referred & cited

KBI v Van Der Walt 48 SATC 104 at 108-10, 1986 (4) SA 303 (T)

referred

CIR v Pick 'n Pay Wholesalers (Pty) Ltd 49 SATC 132 at 147, 1987 (3) SA 453 (A)

Tuck v CIR 50 SATC 98 at 114 & 115, 1988 (3) SA 819 (A)

referred & applied

Gerber v CIR 51 SATC 183 at 187, 190, 192 and 194, 1989 (4) SA 855 (A)

referred, discussed & applied

CIR v SA Mutual Unit Trust Management Company Ltd 52 SATC 205 at 213-4, 219, 221, 222-3, 223-4, 1990 (4) SA 529 (A)

referred

Solaglass Finance Company (Pty) Ltd v CIR 53 SATC 1 at 12, 1991 (2) SA 257 (A)

referred & cited

ITC 1521 (1989) 54 SATC 175 (C) at 182 & 184

referred

ITC 1553 (1989) 55 SATC 105 (T) at 112

Oosthuizen and Another v Standard Credit Corporation Ltd 55 SATC 338 at 351, 1993 (3) SA 891 (A)

referred & cited

CIR v VRD Investments (Pty) Ltd 55 SATC 368 at 380, 1993 (4) SA 330 (C)

referred

ITC 1566 (1993) 56 SATC 34 (C) at 43-4

ITC 1583 (1993) 57 SATC 58 (C) at 61

referred & cited

ITC 1584 (1994) 57 SATC 63 (C) at 70

ITC 1589 (1993) 57 SATC 153 (Z) at 159

referred

ITC 1593 (1994) 57 SATC 251 (T) at 255

referred & cited

ITC 1595 (1993) 57 SATC 321 (N) at 328

referred

Richards Bay Iron & Titanium (Pty) Ltd and Another v CIR 58 SATC 55 at 64 &

66,1996 (1) SA 311 (A)

ITC 1600 (1995) 58 SATC 131 (EC) at 135

ITC 1602 (1995) 58 SATC 205 (N) at 209

ITC 1603 (1995) 58 SATC 212 (N) at 216

CIR v Sunnyside Centre (Pty) Ltd 58 SATC 319 at 324, 1996 (A)

referred

ITC 1619 (1995) 59 SATC 309 (C) at 316

CIR v DG Smith 60 SATC 397 at 402, 1997 (N)

referred & cited

ITC 1636 (1997) 60 SATC 267 (EC) at 316, 326 & 388

ITC 1641 (1998) 60 SATC 493 (C) at 500-2

referred

KBI v Van Blommestein 61 SATC 145 at 154 & 159, [1999] 1 All SA 463 (A)

(Transkei) (Pty) Ltd v CSARS 61 SATC 213 at 216, [1999] 2 All SA 249 (N)

Ticktin Timbers CC v CIR 61 SATC 399 at 401, [1999] 4 All SA 192 (A)

ITC 1644 (1995) 61 SATC 23 (T) at 27

ITC 1694 (1999) 63 SATC 127 (C) at 131

CSARS v Van der Westhuizen 63 SATC 191 at 195-6, 2001 (C)

CSARS v Dunblane (Transkei) (Pty) Ltd 64 SATC 51 at 54, 2001 (SCA)

CSARS v Scribante Construction(Pty) Ltd 64 SATC 379 at 383, 2002 (SCA)

CIR v Louw 45 SATC 113

referred & applied

ITC 1470 (1989) 52 SATC 88 (T) at 96

referred

ITC 1518 (1989) 54 SATC 113 (T) at 133

referred, discussed, cited & distinguished

ITC 1542 (1989) 54 SATC 417 (O) at 421 & 423-4

referred

ITC 1558 (1992) 55 SATC 231 (T) at 246

referred, discussed & cited

ITC 1625 (1995) 59 SATC 383 (T) at 392-5, 395 & 397

referred, cited & applied

ITC 1636 (1997) 60 SATC 267 (EC) at 318, 321, 326, 330, 331-2 & 390

referred

CSARS v Knuth and Industrial Mouldings (Pty) Ltd 62 SATC 65 at 78, 1999 (E)

referred & cited

ITC 1669 (1999) 61 SATC 479 (Z) at 492

Blue Circle Cement Ltd v CIR 46 SATC 21, 1984 (2) SA 764 (A)

referred

ITC 1421 (1986) 49 SATC 78 (C) at 80

referred, cited & distinguished

ITC 1447 51 SATC 53 at 56-57

referred, cited, discussed & applied

ITC 1468 (1989) 52 SATC 32 (C) at 35 & 38

referred, cited & applied

ITC 1469 (1989) 52 SATC 40 (C) at 43-4 & 45

ITC 1479 (1989) 52 SATC 264 (T) at 273-4

CIR v Standard Bank of SA Ltd 47 SATC 179

referred & cited

ITC 1504 (1991) 53 SATC 349 (C) at 352 & 355

ITC 1521 (1989) 54 SATC 175 (C) at 182

ITC 1553 (1989) 55 SATC 105 (T) at 112

CIR v G Brollo Properties (Pty) Ltd 56 SATC 47 at 53-4, 1993 (A)

referred

ITC 1602 (1995) 58 SATC 205 (N) at 211

referred, cited & applied

ITC 1603 (1995) 58 SATC 212 (N) at 215-6

cited

ITC 1604 (1995) 58 SATC 263 (EC), 268

referred

CIR v Elma Investments CC 58 SATC 295 at 296-7, 1996 (C)

Van Blommestein v KBI 59 SATC 221 at 232 & 234, 1997 (C)

referred & applied

CIR v Ticktin Timbers CC 59 SATC 260 at 263, 1997 (C)

referred & cited

ITC 1620 (1995) 59 SATC 316 (T) at 322

referred

CIR v DG Smith 60 SATC 397 at 402, 1997 (N)

referred & cited

ITC 1641 (1998) 60 SATC 493 (C) at 501

Ticktin Timbers CC v CIR 61 SATC 399 at 401-2, [1999] 4 All SA 192 (A)

referred

ITC 1643 (1998) 61 SATC 12 (E) at 18-19

ITC 1690 (1999) 62 SATC 497 (G) at 500

CSARS v 121 Castle Street Cape Town CC 63 SATC 185 at 188, 2001 (C)

ITC 1727 (2001) 64 SATC 275 (C) at 280

De Beers Holdings (Pty) Ltd v CIR 47 SATC 229, 1986 (1) SA 8 (A)

cited & referred

1 Werklik-Aantreklik Beleggings (Edms) Bpk v KBI 48 SATC 112 at 121 & 135,
1986(O)

referred

2 Werklike Aantreklike Beleggings (Edms) Bpk v KBI 50 SATC 47 at 49, 1988 (A)

3 ITC 1524 (1990) 54 SATC 201 (C) at 206

4 CIR v Pick 'n Pay Employee Share Purchase Trust 54 SATC 271 at 280, 1992 (A)

5ITC 1592 (1994) 57 SATC 247 (C) at 250

referred, discussed & cited

6 Richards Bay Iron & Titanium (Pty) Ltd and Another v CIR 58 SATC 55 at 68 &
712, 1996 (1) SA 311 (A)

referred & cited

7 CIR v Sunnyside Centre (Pty) Ltd 58 SATC 319 at 325-6, 1996 (A)

8 ITC 1644 (1995) 61 SATC 23 (T) at 27

9 ITC 1662 (1999) 61 SATC 357 (C) at 361

referred & considered

10 Syfrets Participation Bond Managers Ltd v CSARS 63 SATC 1 at 6-7 , 2000(SCA)

referred & cited

11 ITC 1700 (1997) 63 SATC 206 (O) at 212

12 CSARS v AA The Motorist Publications (Pty) Ltd 63 SATC 325, 2001 (C) at 329

referred

13 ITC 1720 (1999) 64 SATC 80 (G)at 87

referred & distinguished

14 ITC 1723 (1999) 64 SATC 165 (G) at 173

CIR v Pick 'n Pay Wholesalers (Pty) Ltd 49 SATC 132, 1987 (3) SA 453 (A)

referred & discussed

Solaglass Finance Company (Pty) Ltd v CIR 53 SATC 1 at 20, 1991 (2) SA 257 (A)

referred

ITC 1499 (1989) 53 SATC 266 (T) at 272

ITC 1518 (1989) 54 SATC 113 (T) at 130

ITC 1614 (1995) 59 SATC 236 (T) at 243

referred & cited

ITC 1627 (1997) 60 SATC 26 (T) at 31

ITC 1641 (1998) 60 SATC 493 (C) at 497

Tickin Timbers CC v CIR 61 SATC 399 at 403, [1999] 4 All SA 192 (A)

referred & discussed

ITC 1700 (1997) 63 SATC 206 (O) at 212

referred & cited

ITC 1727 (2001) 64 SATC 275 (C) at 278

Tuck v CIR 50 SATC 98

referred & applied

ITC 1479 (1989) 52 SATC 264 (T) at 275

referred

ITC 1512 (1989) 54 SATC 45 (Z) at 55

ITC 1518 (1989) 54 SATC 113 (T) at 131

ITC 1521 (1989) 54 SATC 175 (C) at 183

referred & applied

CIR v VRD Investments (Pty) Ltd 55 SATC 368 at 381, 1993 (4) SA 330 (C)

referred, discussed, cited & applied

ITC 1703 (1999) 63 SATC 247 (C) at 253-5

CSARS v McRae 64 SATC 1 at 6-7, 2001 (C)

referred, cited & applied

ITC 1725 (2000) 64 SATC 223 (C) at 230-1

referred

ITC 1732 (2000) 64 SATC 403 (G) at 407

CSARS v Heron Heights CC 64 SATC 433 at 446, 2002 (EC)

Edgars Stores Ltd v CIR 50 SATC 81, 1988 (3) SA 876 (A)

referred & applied

ITC 1485 (1990) 52 SATC 337 (T) at 341-2

ITC 1496 (1990) 53 SATC 229 (T) at 238

referred

ITC 1531 (1991) 54 SATC 323 (T) at 330

referred & cited

CIR v Golden Dumps (Pty) Ltd 55 SATC 198 at 206, 1993 (A)

referred

ITC 1587 (1994) 57 SATC 97 (T) at 103

ITC 1588 (1994) 57 SATC 148 (C) at 151

ITC 1634 (1997) 60 SATC 235 (T) at 257

ITC 1697 (1999) 63 SATC 146 (N) at 159

CIR v Golden Dumps (Pty) Ltd 55 SATC 198

referred

CIR v Felix Schuh (SA) (Pty) Ltd 56 SATC 57 at 69-70, 1994 (A)

ITC 1587 (1994) 57 SATC 97 (T) at 103

ITC 1634 (1997) 60 SATC 235 (T) at 247 & 257

referred & cited

ITC 1725 (2000) 64 SATC 223 (C) at 232-3

Henbase 3392 (Pty) Ltd v CSARS and Another 64 SATC 203 at 213-4, 2002 (2) SA
(SCA)

Essential Sterolin Products (Pty) Ltd v CIR 55 SATC 357

referred

ITC 1585 (1994) 57 SATC 81 (T) at 87

referred & cited

First National Bank of Southern Africa Ltd v CSARS 64 SATC 245 at 250-1, 2002
(SCA)

Referred & applied

First National Bank of Southern Africa Ltd v CSARS 64 SATC 245 at 252, 2002
(SCA)

CIR v Felix Schuh (SA) (Pty) Ltd 56 SATC 57, 1994 (2) 801 (A)

referred & cited

Sentra-Oes Koöperatief Bpk v KBI 57 SATC 109 at 115, 1995 (A)

referred

ITC 1588 (1994) 57 SATC 148 (C) at 151

ITC 1634 (1997) 60 SATC 235 (T) at 248

ITC 1650 (1998) 61 SATC 72 (C) at , 79

Rudolph and Another v CIR and Others 58 SATC 219, 1996 (7) BCLR 889 (CC)

58 SATC 183, [1996] 2 All SA 553 (A)

referred

Naidoo and Another v CIR 58 SATC 251 at 259, 1996 (SE)

Rudolph and Another v CIR and Others 59 SATC 399 at 403, 1997 (4) SA 391 (SCA)

CCE v Container Logistics (Pty) Ltd and Rennies Group Ltd t/a Renfreight 62 SATC
138 at 143, 1999 (3) SA 771 (SCA)

referred & applied

First National Bank of SA Ltd t/a Wesbank v CSARS and Another 63 SATC 432 at
436, 2001 (7) BCLR 715 (C)

referred

Haynes v CIR 64 SATC 321 at 345, 2000 (6) BCLR 596 (Tk)