

CAUSATION AND THE CONCOMITANT ISSUE OF APPORTIONMENT WITH REFERENCE TO GROSS INCOME IN SOUTH AFRICAN INCOME-TAX LAW

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I INTRODUCTION

The expression 'gross income' is defined in the Income Tax Act¹ ('the Act') as follows:

"'gross income', in relation to any year or period of assessment, means, in the case of any person, the total amount, in cash or otherwise, received by or accrued to or in favour of such person during such year or period of assessment from a source within or deemed to be within the Republic, excluding receipts or accruals of a capital nature. . . ."

The objective of this article is twofold: first, to set out the correct role, in our view, of the notion of causation in the application of two elements of the definition of gross income—the characterization of an amount as being from a source within the Republic (or not) and as being of a capital nature (or not); and secondly, to ascertain the apportionment implications where two or more *causae* with differing tax consequences are found to have given rise to the receipt or accrual of a single amount.

In his book *The Best Defense* Professor Alan Dershowitz of Harvard Law School makes the following wry comments:

'I am reminded of my colleague Alan Stone's observation that there are no Nobel prizes in law, because law is the only profession where you lose points for originality and gain points for demonstrating that somebody else thought of your idea first. Lawyers are prone to look to the "authorities"—to past lawyers and judges—for their ideas. Creativity in the law consists largely of analyzing past cases

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¹ Act 58 of 1962, as amended.

so as to get around a barrier or move the law incrementally. Rarely do lawyers indulge in bold leaps of faith, in grand conceptual breakthroughs.²

It is submitted that several recent tax decisions³ of the Appellate Division of the Supreme Court have displayed an innovative approach with often quite dramatic results—something more than Dershowitz's 'moving the law incrementally'. Certain of these decisions, discussed below, hold important implications, if our view is correct, for the role of causation and apportionment in the determination of a taxpayer's gross income.

II THE NEED TO DETERMINE CAUSATION

(a) Source

Our discussion of the law relating to the determination of the source of an amount for income-tax purposes is limited to what we might call the *natural source* of an amount, as opposed to its *deemed source*.⁴

There is no definition of 'source' in the Act. The result is that the principles of law which govern the meaning of 'source' have been laid down by the courts. The leading case on the subject is *Commissioner for Inland Revenue v Lever Bros & another*,⁵ which has without fail been followed in subsequent decisions dealing with the question of source. In the *Lever Bros* case Watermeyer CJ, who delivered one of two majority judgments, made the following authoritative remarks:

'When the question has to be decided whether or not money, received by a taxpayer, is gross income within the meaning of the definition referred to above, two problems arise which have not always been differentiated from one another in decided cases. The first problem is to determine what is the source from which it has been received and when that has been determined, the second problem is to locate it in order to decide whether it is or is not within the Union.

'The word "source" has several possible meanings. In this section it is used figuratively, and when so used in relation to the receipt of money, one possible meaning is the originating cause of the receipt of the money, another possible meaning is the quarter from which it is received. A series of decisions of this court and of the Judicial Committee of the Privy Council upon our Income Tax Acts and upon similar Acts elsewhere have dealt with the meaning of the word "source", and the inference, I think, which should be drawn from those decisions is that the source of receipts, received as income, is not the quarter whence they come, but the originating cause of their being received as income, and that this originating cause is the work which the taxpayer does to earn them, the *quid pro quo* which he gives in return for which he receives them.'⁶

² Alan M Dershowitz *The Best Defense: The Courtroom Confrontations of America's Most Outspoken Lawyer of Last Resort* (1982) 307. He goes on to add in parenthesis: 'I recall my high school Talmud teacher once putting me down with the following "Catch 22" response for claiming that an idea I had was original: "If what you're saying is such a good idea, then obviously the old rabbis, who were much smarter than you, must have thought of it first; and if the old rabbis, who were much smarter than you, didn't think of it first, then it can't be such a good idea.'

³ For example, *Commissioner for Inland Revenue v Nemojim (Pty) Ltd* 1983 (4) SA 935 (A); *De Beers Holdings (Pty) Ltd v Commissioner for Inland Revenue* 1986 (1) SA 8 (A); *Tuck v Commissioner for Inland Revenue* 1988 (3) SA 819 (A).

⁴ The deemed-source provisions are to be found principally in ss 9 and 9A of the Act.

⁵ 1946 AD 441.

⁶ At 449–50.

Flowing from the above dictum, it is trite law that the test for the source of an amount involves a twofold inquiry: what is the originating cause (*quid pro quo*) of the amount, and where is that cause located? There is thus no doubt of the need to determine the *causa* giving rise to the receipt or accrual of an amount in order to discover its source.

(b) *Capital or revenue*

As in the case of source, there is no definition of the words 'of a capital nature' in the Act, and the legal principles which govern their meaning have been laid down by the courts. Unlike in the area of source, however, judicial precedent has not traditionally directed us to examine the *causa* giving rise to the receipt or accrual of an amount in order to decide whether or not it is of a capital nature. Yet this is exactly what the tests for capital or revenue require us to do: in most cases this is so obvious that there has been no need to spell out the exact nature of the inquiry.

In many cases the distinction between amounts of a capital nature and amounts of a revenue nature is clear. Amounts received for the *use* of assets, or for services rendered, for example, are amounts of a revenue nature. On the other hand, amounts such as gifts and inheritances, or the proceeds of the sale of an asset which has been used as part of one's income-earning structure, are amounts of a capital nature. The difficulties presented by the need to distinguish capital amounts from revenue amounts are not theoretical difficulties of defining what is capital and what is revenue, but practical difficulties of applying the law to the facts of individual situations. These difficulties usually arise where there has been a purchase and subsequent sale of an asset, and it is necessary to determine the capital or revenue nature of the proceeds. The asset may have been held as an investment made with the intention of earning income, in which case the proceeds will be of a capital nature. Alternatively, the asset may have been held (in a scheme of profit-making) as trading stock with a view to the profitable resale of it, in which case the proceeds will be of a revenue nature.

It is not our purpose to embark on a discussion of the nuances of the well-established tests for distinguishing between capital and revenue. What concerns us is the *nature* of the inquiry; more particularly, the so obvious as to be almost unnoticed role of causation in this inquiry.

It is our contention that whenever one examines the capital or revenue nature of an amount received or accrued, one always asks: what has given rise to this receipt or accrual, or, to borrow the test in the *Lever Bros* case, what is the *originating cause* of the amount received or accrued?

Two simple examples will illustrate the point. Where a salary is

received, the originating cause of the receipt is the services rendered, and one will conclude from the inherent nature of this underlying causa that the amount received is of a revenue nature. On the other hand, where a payment is received in return for a restraint-of-trade undertaking in terms of which the recipient undertakes not to carry on a trade in a specified area for a specified period of time, the quid pro quo for or originating cause of the payment received is the undertaking to refrain from trading as specified. The courts have told us that this amounts to the sterilization of a capital asset and the payment received is accordingly of a capital nature.⁷ Again it is with reference to the underlying causa that we characterize the payment as being of a capital nature.

At a later stage we shall consider a more complex example of the causation of an amount received. At this stage the point being made is simply that it is the underlying causa which triggers the application of the tests for capital or revenue.

Thus the two inquiries necessitated by the definition of gross income regarding the capital or revenue nature and the source of an amount require as their starting-point a consideration of the causa giving rise to the amount. In the case of source this is because the *Lever Bros* case⁸ tells us so; in the case of capital and revenue, it is patent that this is fundamental to all of the tests to be applied, and the Appellate Division has confirmed that this is so in *Tuck v Commissioner for Inland Revenue*,⁹ discussed below.

III DETERMINATION OF CAUSATION

In the ascertainment of the source of amounts received or accrued, the *Lever Bros* case requires us to determine the originating cause and specifies that

'this originating cause is the work which the taxpayer does to earn them, the quid pro quo which he gives in return for which he receives them. The work which he does may be a business which he carries on, or an enterprise which he undertakes, or an activity in which he engages and it may take the form of personal exertion, mental or physical, or it may take the form of employment of capital either by using it to earn income or by letting its use to someone else. Often the work is some combination of these.'¹⁰

In *Tuck's* case,¹¹ which was concerned with the capital or revenue nature of shares received by the appellant, Corbett JA expressly approved the use of the originating cause, or quid pro quo, test for the purpose of characterizing the receipt of the shares as being of a capital or revenue nature for income-tax purposes. Having done so, he went on to ask the following question:

⁷ *Taeuber and Corssen (Pty) Ltd v Secretary for Inland Revenue* 1975 (3) SA 649 (A) at 663H-664A.

⁸ *Supra* note 5.

⁹ 1988 (3) SA 819 (A).

¹⁰ *Per Watermeyer CJ* at 450.

¹¹ *Supra* note 9.

'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?'¹²

It is of considerable interest that in this context Corbett JA in *Tuck's* case paused to consider the question of causation in delict, setting out the well-established distinction between factual causation (*conditio sine qua non*) and legal causation (remoteness), and citing cases such as *Da Silva & another v Coutinho*,¹³ *Minister of Police v Skosana*,¹⁴ *Standard Bank of South Africa Ltd v Coetsee*,¹⁵ *S v Daniëls en 'n ander*¹⁶ and *Siman & Co (Pty) Ltd v Barclays National Bank Ltd*.¹⁷ Corbett JA made the following comments:

'I do not propose to canvass fully the discussion of this question in these judgments. Suffice it to say that it is generally recognized that causation in the law of delict gives rise to two distinct inquiries. The first, often termed "causation in fact" or "factual causation", is whether there is a factual link of cause and effect between the act or omission of the party concerned and the harm for which he is sought to be held liable; and in this sphere the generally recognized test is that of the *conditio sine qua non* or the "but for" test. This is essentially a factual inquiry. Generally speaking no act or omission can be regarded as a cause in fact unless it passes this test. The second inquiry postulates that the act or omission is a *conditio sine qua non* and raises the question as to whether the link between the act or omission and the harm is sufficiently close or direct for legal liability to ensue; or whether the harm is, as it is said, "too remote". This inquiry (sometimes called "causation in law" or "legal causation") is concerned basically with a juridical problem in which considerations of legal policy may play a part. One of the factors which may cause the link between the act or omission and the harm to become too tenuous (resulting in the harm being too remote) is the intervention of some independent, unconnected and extraneous causative factor or event, generally termed a *novus actus interveniens*.¹⁸

Corbett JA expressed doubt concerning the appropriateness of applying the principles of causation, as developed in the law of delict and in criminal law, when characterizing a receipt for income-tax purposes,¹⁹ yet he reverted to these principles later in his judgment (see below) and seems to have applied them in holding that both the *causae* in *Tuck's* case had to be regarded in law as causally relevant factors. It is interesting to note that Boberg rejects Corbett JA's traditional distinction²⁰ between factual and legal causation in delict, preferring what he calls 'the relative view of negligence', but acknowledges that *Skosana's* case²¹ stands in the way of its acceptance.²² Boberg states that

'the issue of legal causation holds no terrors for those who take a relative view of wrongfulness and fault—it simply does not exist. For the active role accorded these requirements in limiting the actor's liability makes it unnecessary to invoke a further requirement of legal causation for the purpose. Factual causation is an

¹² At 833D–E.

¹³ 1971 (3) SA 123 (A) at 147D–148E.

¹⁴ 1977 (1) SA 31 (A) at 33A–B, 34F–35D, 43E–44F.

¹⁵ 1981 (1) SA 1131 (A) at 1138G–1139C.

¹⁶ 1983 (3) SA 275 (A) at 324F–325E, 331B–333G.

¹⁷ 1984 (2) SA 888 (A) at 914F–915B.

¹⁸ *Supra* note 9 at 832G–833A.

¹⁹ At 833C.

²⁰ Embodied in *Minister of Police v Skosana* *supra* note 14.

²¹ *Supra* note 14.

²² P Q R Boberg *The Law of Delict I: Aquilian Liability* (1984) 276 and 382.

entirely sufficient link between harm and conduct where it is further required that the conduct be wrongful and culpable *in relation to* the harm that it caused.²³

Boberg's preferred relative view seems particularly remote (no pun intended) where causation in the context of income tax is concerned, and it appears to us that the more traditional approach of Corbett JA—the determination, first, of factual causation and, secondly, of legal causation—is preferable for income-tax purposes. And where legal causation, or the remoteness test, is concerned, it is our view that for income-tax purposes it is only the direct-consequences test, which looks for the operation of a *novus actus interveniens*, which is of any assistance. Further tests,²⁴ such as the foreseeability test and the test of adequate causation, appear too closely linked to the question of negligence, which is generally not a relevant factor when it comes to the *causa* of an amount received or accrued.

Whether the principles of legal causation have been received into our income-tax law in *Tuck's case*²⁵ is not clear. As was noted above, Corbett JA expressed reservations concerning their appropriateness in income-tax law and indeed reached the same conclusion by applying the *Lever Bros* test, which he expressly favoured. Thus it may be that Corbett JA's remarks in regard to legal causation are merely *obiter dicta*. It is submitted that there can be little doubt, however, that in a situation where these principles would assist in the determination of causation for income-tax purposes, the court would not hesitate to employ them.

Indeed, in *Commissioner for Inland Revenue v Shell Southern Africa Pension Fund*²⁶ Nicholas JA expressly applied the principles of legal causation in the context of paragraph (e) of the definition of gross income. The issue was whether a lump sum paid by a pension fund, at the discretion of the pension committee, to the widow of a deceased member was a lump sum which became recoverable 'in consequence of' or 'following upon' the death of the member. Nicholas JA made the following comments:

"The paradigm of the present case is an occurrence A (the death of a member) which initiates a chain of events leading to the final result B (the recoverability of the lump sum benefit), one of the intervening events being occurrence C (the exercise by the committee of its discretion).

"The question is whether the intervening cause C, which contributes to bring about the result B, is of such a kind that it isolates the original cause A so as to relegate it "to the status of a merely historical antecedent or background feature".²⁷

In this case it was found that the decision of the committee did amount to the intervention of 'an independent, unconnected and extraneous causative factor or event',²⁸ which isolated the death of the

²³ Op cit at 439–40.

²⁴ These categories of legal causation are used by Boberg op cit at 440–7.

²⁵ Supra note 9.

²⁶ 1984 (1) SA 672 (A) at 679B–F.

²⁷ At 679E–G.

²⁸ At 679G–H.

member from the final result. The lump sum, it was held, had therefore not become recoverable in consequence of or following upon the death of the member.

In *Transvaal Associated Hide and Skin Merchants (Pty) Ltd v The Collector of Income Tax*,²⁹ decided by the Botswana Court of Appeal, Schreiner JA, dealing with the source of the proceeds of the sale of cured hides, and having dismissed the possibility of apportionment because the appellant had failed to include apportionment as one of his grounds of objection, stressed the need to choose between the country where the hides were cured, Botswana, and the country where they were sold, South Africa. He made the following comments:

'In such a situation, it has been held that the dominant (or main or substantial or real and basic) cause of the accrual of the income must be sought.'³⁰

He then went on to make the following remarks:

'No doubt selling the cured hides is necessary to bring an income to hand, so that it might be said of the sales, as much as of the curing, that they are a *causa sine qua non* of the accrual of the income. But the place where a *causa sine qua non* exists cannot be decisive of the place of origin of the income, for there may be a number of *causae sine qua non*. One must look for something more—something like the dominance or the basicity used in the abovementioned list of expressions; or like what I venture to call the highest, or higher, degree of essentiality.'³¹

The court in the *Transvaal Hide* case, as is indicated by Schreiner JA, was obliged to choose between Botswana, where the hides were cured, and South Africa, where they were sold. In so doing it is submitted that the court looked for the dominant cause or what Schreiner JA called the *causa* with 'the highest, or higher, degree of essentiality'. The words 'highest or higher' clearly indicate that it was the dominant *causa* which was the subject-matter of Schreiner JA's inquiry.

What is of particular interest is that Schreiner JA appears to have gone some way towards applying the concepts of factual and legal causation, referred to above. Indeed, one might ask what difference there is between the inquiry suggested by Schreiner JA and the application of the tests for factual causation (*causa sine qua non*) and legal causation (remoteness, as distinct from what Schreiner JA calls 'essentiality').

We have already noted that because apportionment was not included in the appellant's grounds of objection, an actual apportionment was ruled out by Schreiner and Maisels JJA. This led them to look for a single dominant *causa* to settle the issue.

Schreiner and Maisels JJA both implied quite clearly that in an appropriate case apportionment would be acceptable. This, it is submitted, would require the ascertainment not of a dominant *causa*

²⁹ 1967, reported in *Republic of Botswana Law Reports 1964-1967* 207.

³⁰ At 219.

³¹ At 219.

but of two or more legal *causae* having what we might call 'sufficient essentiality'—in other words, not too remote—on the basis of which an apportionment could be made. It is in the context of such a possibility that the remarks of Schreiner JA, quoted above, are of great interest, in particular his reference to *causae sine qua non* and to 'the . . . degree of essentiality'.

It is our contention that in a case where apportionment is pleaded by the taxpayer in his objection and appeal, expressions such as 'dominant (or main or substantial or real and basic)' would give way to a test for legal as opposed to factual causation along the lines indicated by Nicholas JA in the *Shell Pension Fund* case³² and Corbett JA in *Tuck's* case,³³ and implied, if our interpretation is accepted, by the comments of Schreiner JA cited above.

The *Shell Pension Fund* case should perhaps be treated with some caution, as it dealt with paragraph (e) of the definition of gross income and not with the general definition, and the *Transvaal Hide* decision is of course a Botswana decision and not binding in South Africa (the towering legal stature of Schreiner JA notwithstanding). On the authority of *Tuck's* case, however, it is submitted that the correct inquiry may properly proceed along the following lines.

In determining a *causa* for the purpose of ascertaining the source and also the capital or revenue nature of an amount received or accrued, one must enquire what is the originating cause, or *quid pro quo*, giving rise to it. Should this inquiry produce an equivocal result, it is submitted that one should ascertain the factual cause (or causes) (*conditio(nes) sine qua non*) giving rise to the amount, and then determine whether such cause (or causes), having regard to any *novus actus interveniens*, can also be considered as a legal cause (or legal causes).

It needs to be stressed that the determination of a *causa* or of *causae* in the above manner in no way detracts from any of the traditional tests for determining the capital or revenue nature of an amount received or accrued. These tests must simply be applied separately in relation to each separate *causa*.

Let us examine the possible application of these principles of causation in the context of a typical set of facts giving rise to difficulties in the determination of the capital or revenue nature of an amount received. Let us assume that Mr X purchased a piece of land for an amount of R1 million and five years later, having subdivided the land into individual plots, sold all of the land for R10 million.

The traditional test for determining the capital or revenue nature of the R10 million received requires us to determine Mr X's intention on the date of acquisition of the land and to determine whether any

³² *Supra* note 26.

³³ *Supra* note 9.

change of intention has taken place prior to its disposal. In *Commissioner for Inland Revenue v Stott*³⁴ Wessels JA said:

'It is unnecessary to go so far as to say that the intention with which an article or land is bought is conclusive as to whether the proceeds derived from a sale are taxable or not. It is sufficient to say that the intention is an important factor and unless some other factor intervenes to show that when the article was sold it was sold in pursuance of a scheme of profit-making, it is conclusive in determining whether it is capital or gross income.'³⁵

If Mr X acquired the land with a view to the profitable resale of it (in pursuance of a scheme of profit-making), then, if there has been no change of intention, the amount of R10 million received will be of a revenue nature. If, on the other hand, Mr X acquired the land as an investment (for example, in order to derive rental income from it), he is entitled to realize his capital asset to best advantage. As Wessels JA said in *Stott's* case:

'Every person who invests his surplus funds in land or stock or any other asset is entitled to realize such asset to best advantage and to accommodate the asset to the exigencies of the market in which he is selling. The fact that he does so cannot alter what is an investment of capital into a trade or business for earning profits.'³⁶

If on the other hand Mr X had changed his intention since the date of acquisition of the land and was holding it as trading stock at the time of its disposal, the proceeds of R10 million will be characterized as an amount of a revenue nature.³⁷ In deciding whether Mr X has changed his intention, it might be discovered that Mr X had mixed intentions, in which case his dominant intention must prevail.³⁸

The test for capital or revenue is trite law, but it behoves us to ask how the notion of causation, as enunciated by Corbett JA in *Tuck's* case,³⁹ might apply in this context. If we employ the *Lever Bros* test, it will be apparent that there are three possible originating causes giving rise to the R10 million received: the purchase of the land, its subdivision into plots, and the sale of the land.

In the ascertainment of the capital or revenue nature of the proceeds, in our opinion the correct procedure is not to determine which of these possible originating causes is the dominant one, but rather to determine, where necessary, which cause or causes should in law be considered as causally relevant factors. In doing so it must be decided which of these conditions sine qua non, having regard to their possible remoteness from the receipt of the proceeds of R10 million, can be considered as causes in law in accordance with the principles of legal causation. We shall consider four possibilities:

(a) *Mr X acquired the land for investment purposes and, without changing*

³⁴ 1928 AD 252.

³⁵ At 264.

³⁶ At 263.

³⁷ *Natal Estates Ltd v Secretary for Inland Revenue* 1975 (4) SA 177 (A).

³⁸ Per Schreiner JA in *Commissioner of Taxes v Levy* 1952 (2) SA 413 (A) at 421pr-A.

³⁹ *Supra* note 9.

this capital intention, simply disposed of his asset to best possible advantage.

In this case, if we apply the test for capital or revenue to each of the three conditions sine qua non enumerated above, they will each point to the same conclusion—that the proceeds are of a capital nature. There is thus no need to go further and distinguish legal causation from factual causation.

(b) *Mr X acquired the land with a view to the profitable resale of it in a scheme of profit-making, and simply proceeded to carry out this intention in selling the land for R10 million.*

As in the case of (a), an application of the test for capital or revenue to each of the possible causes points to the same conclusion: the proceeds are of a revenue nature. Again, there is no need to go further and distinguish legal causation from factual causation.

(c) *Mr X acquired the land for investment purposes but has changed his intention and embarked on a scheme of profit-making, using the land as his trading stock.*

On the facts assumed, a court would probably (although not necessarily) base its conclusion that Mr X had changed his intention on the fact that he had subdivided the land into plots and thereby ‘crossed the Rubicon’⁴⁰ and embarked on a scheme of profit-making. In this event it is submitted that Mr X’s change of intention would constitute a novus actus interveniens relegating the purchase of the land to a (remote) conditio sine qua non or, in the words quoted by Nicholas JA in the *Shell Pension Fund* case, a mere ‘historical antecedent or background feature’.⁴¹ Only the subdivision of the land into plots and the sale of them would then be regarded as causally relevant factors in law, and the application of the capital or revenue test to each of these causes would yield the conclusion that the proceeds of R10 million are of a revenue nature.

(d) *Mr X acquired the land with a view to the profitable resale of it in a scheme of profit-making, but has changed this intention and subsequently disposed of the land held as a capital asset to best advantage.*

Based on the reasoning in (c) above, Mr X’s change of intention would constitute a novus actus interveniens, once again relegating the purchase of the land to a mere ‘historical antecedent or background feature’. In this event an application of the capital or revenue test to each of the causally relevant factors in law—the subdivision of the land into plots and the sale of them—would lead us to the conclusion that the proceeds of R10 million are of a capital nature.

We have attempted in the four possibilities set out above to apply the principles of causation as accepted by the Appellate Division in *Tuck’s case*⁴² to the capital or revenue issues arising from the purchase

⁴⁰ Supra note 37 at 203A.

⁴¹ Supra note 27.

⁴² Supra note 9.

and sale of an asset, and to marry this approach with the traditional approach adopted by the courts. If the analysis is correct, what emerges is that the need to distinguish between factual and legal causation in the case of the purchase and sale of an asset arises only where there has been a change of intention on the part of the taxpayer. Such a change of intention will constitute a *novus actus interveniens*, and the *conditio(nes) sine qua non* which have preceded it will have become causally irrelevant in law. The test for capital or revenue, which amounts to a determination of the taxpayer's intention, need only be applied to each of the subsequent *causae*, and these—if indeed there is more than one—will invariably yield the same conclusion.

It would appear that a taxpayer's change of intention *per se* can constitute a *novus actus interveniens* and only the legal *causae* which occur subsequent to it will each require an application of the test for capital or revenue. It is difficult in the present context to conceive of the legal causes remaining after the latest *novus actus interveniens* leading to divergent conclusions as regards capital or revenue.

It would further appear that where a taxpayer has mixed intentions which subsequently crystallize into a dominant intention, the advent of this dominant intention will—following the above reasoning—itself constitute a *novus actus interveniens*, resulting in the application of the test for capital or revenue only to subsequent *causae*.

IV APPORTIONMENT

What happens if the inquiry regarding causation results in the establishment of more than one legal *causa* for the receipt or accrual of an amount, and after the capital or revenue tests have been applied to each, it is determined that the amount comprises both a capital and a revenue element? Similarly, what if the causation inquiry concludes that a single amount has a multiplicity of sources both within and outside of the Republic? Is an apportionment competent under South African income-tax law? In other words, is it possible for an amount to be split up so that part of it is to be regarded as arising from a Republic source and the other part not? Similarly, can a single amount be split up into capital and revenue components? The situation envisaged is one where the portions of the amount relating to the capital and revenue, or Republic and non-Republic source, elements, as the case may be, cannot be identified as separate amounts. If separate amounts can be identified, an allocation (as opposed to an apportionment) is clearly possible. This is trite law.

Before we examine the notion of apportionment in relation to the source and the capital or revenue nature of an amount, it is appropriate to ascertain whether the courts have approved of apportionment in any other income-tax context.

In *Secretary for Inland Revenue v Guardian Assurance Holdings (SA)*

*Ltd*⁴³ the Appellate Division, despite the absence of statutory authorization, approved of the apportionment of expenditure claimed under s 11(a) of the Act in a case where the taxpayer incurred expenditure partly of a capital nature and partly of a revenue nature. The Appellate Division has also approved of the apportionment of expenditure claimed under s 11(a) where the expenditure was incurred in the production of an amount comprised of both income and exempt income.⁴⁴ Where expenditure has been incurred partly for private purposes and partly for trade purposes, no apportionment is possible, as s 23(g) of the Act prohibits the deduction of expenditure which is not 'wholly or exclusively laid out or expended for the purposes of trade'.⁴⁵

Apportionment has also been approved of in the application of certain of the provisions of s 7⁴⁶ of the Act which deem income to have accrued to a person in specified circumstances. In order for the deeming provisions to apply, one of the requirements to be met is that a 'donation, settlement or other disposition' must take place as a result of which income is received by or accrues to a person. In this regard it has been held that 'other disposition' covers any disposal of property in which there is an appreciable element of gratuitousness and liberality or generosity,⁴⁷ and that if income has accrued or been received as a result of both elements of gratuitousness and consideration, there is 'no reason why in those circumstances the income should not then be apportioned between the two elements'.⁴⁸

Apportionment of amounts as between capital and revenue

In *Tuck's case*⁴⁹ the Appellate Division approved of the principle of apportionment where a receipt of an amount, having regard to its quid pro quo, contained both an income element and an element of a capital nature. The appellant in this case was the managing director of a pharmaceutical company who had received certain shares in terms of a management-incentive plan. The court held that the receipt of the shares was attributable partly to a restraint-of-trade condition and

⁴³ 1976 (4) SA 522 (A).

⁴⁴ *Commissioner for Inland Revenue v Rand Selections Corporation Ltd* 1956 (3) SA 124 (A); *Commissioner for Inland Revenue v Nemojim (Pty) Ltd* 1983 (4) SA 935 (A). Other cases in which the courts have, in principle, approved of apportionment of expenditure laid out for a dual or mixed purpose are *Borstlap v Sekretaris van Binnelandse Inkomste* 1981 (4) SA 836 (A); ITC 607 (1945) 14 SATC 366 at 369; *Schonegevel v Commissioner for Inland Revenue* 1937 CPD 258; ITC 800 (1954) 20 SATC 266; ITC 832 (1956) 21 SATC 320; *Local Investment Co v Commissioner of Taxes* 1958 (3) SA 34 (SR); ITC 703 (1950) 17 SATC 208.

⁴⁵ *Commissioner for Inland Revenue v Pick 'n Pay Wholesalers (Pty) Ltd* 1987 (3) SA 453 (A); ITC 698 (1950) 17 SATC 97; ITC 734 (1951) 18 SATC 202; ITC 847 (1957) 22 SATC 77. In practice s 23(g) is not strictly applied, and an apportionment of expenditure incurred both for trade purposes and for other purposes is often allowed (see *Aubrey S Silke, Costa Divaris & Michael L Stein Silke on South African Income Tax* 10 ed (1982) 333).

⁴⁶ Section 7(3)–7.

⁴⁷ *Ovenstone v Secretary for Inland Revenue* 1980 (2) SA 721 (A).

⁴⁸ Per Trollop JA at 740D–E.

⁴⁹ *Supra* note 9.

partly to his services rendered, and that as the restraint element was of a capital nature, an apportionment was appropriate. Corbett JA, who delivered the unanimous decision of the court, said:

‘There is, so far as I am aware, no authority for this proposition in our case law. Nevertheless, for reasons similar to those stated in the cases quoted in the previous paragraph,⁵⁰ it seems to me that in a proper case apportionment provides a sensible and practical solution to the problem which arises when a taxpayer receives a single receipt and the *quid pro quo* contains two or more separate elements, one or more of which would characterize it as capital. It could hardly have been the intention of the legislature that in such circumstances the receipt be regarded wholly as an income receipt, to the disadvantage of the taxpayer, or wholly as a capital receipt, to the detriment of the *fiscus*. And it is of some interest to note that the solution of apportionment in cases of this nature has been adopted in England (see *Tilley v Wales (Inspector of Taxes)* [1943] AC 386 at 393–4, 398; *Carter v Wadman (HM Inspector of Taxes)* (1946) 28 TC 41 at 52–3) and in Australia (see *McLaurin v Federal Commissioner of Taxation* (1961) 8 AITR 180 at 191).⁵¹

With regard to the basis of apportionment, Corbett JA held that, having regard to the inherent nature of the receipt and its origin in the incentive plan, it was not possible to find an arithmetical basis for apportionment, but he did not regard this as an insurmountable problem. The court considered that a 50/50 apportionment would be fair and reasonable.

It is submitted, with respect, that the Appellate Division’s acceptance in *Tuck’s* case of the principle of apportionment in the circumstances in question is unassailable. The determination of the *causae* giving rise to the receipt or accrual of an amount and the application of the normal tests for capital and revenue in respect of each *causa* is a procedure that conflicts with no statutory rule or precedent. It involves no more than a natural extension of a principle readily applied by the Appellate Division in relation to expenditure and deemed income. The difference between receipts and accruals, on the one hand, and expenditure and the deeming of income in the circumstances contemplated in s 7 of the Act, on the other, is not of such a nature as to preclude the extension of the principle of apportionment.

Apportionment of amounts as between sources within and outside the Republic

Can the principle of apportionment be applied in relation to source?⁵² In this regard Watermeyer CJ made the following comments in the *Lever Bros* case:

⁵⁰ The cases quoted are *Secretary for Inland Revenue v Guardian Assurance Holdings (SA) Ltd* supra note 43; *Borstlap v Sekretaris van Binnelandse Inkomste* supra note 44; *Commissioner for Inland Revenue v Nemojim (Pty) Ltd* supra note 44; and *Ovenstone v Secretary for Inland Revenue* supra note 47.

⁵¹ At 834G–J.

⁵² The only statutory provision expressly authorizing apportionment is s 30 of the Act, which provides for an apportionment of income from a business where the business extends beyond the Republic.

"Turning now to the problem of locating a source of income, it is obvious that a taxpayer's activities, which are the originating cause of a particular receipt, need not all occur in the same place and may even occur in different countries, and, consequently, after the activities which are the source of the particular "gross income" have been identified, the problem of locating them may present considerable difficulties, and it may be necessary to come to the conclusion that the "source" of a particular receipt is located partly in one country and partly in another. See remarks of Lord Atkin in *Rhodesian Metals Ltd (in liquidation) v Commissioner of Taxes* 1940 AD 432 (PC) at 436. Such a state of affairs may lead to the conclusion that the whole of a receipt, or part of it, or none of it, is taxable as income from a source within the Union, according to the particular circumstances of the case, but I am not aware of any decision which has laid down clearly what would be the governing consideration in such a case."⁵³

Watermeyer CJ left open the question of apportionment, and the Supreme Court of South Africa has yet to be confronted with the issue.⁵⁴ However, in *Commissioner for Inland Revenue v Epstein*⁵⁵ Schreiner JA, in a dissenting judgment, accepted that in certain circumstances apportionment is possible. He made the following comments:

'Where work has been done in producing or improving raw material which is sold elsewhere by the same person, it might be possible to apportion. . . .'⁵⁶

At first glance, *Commissioner for Inland Revenue v Black*⁵⁷ may appear to support the view that apportionment of amounts as between different sources is not possible in our income-tax law, and that when there are two or more originating causes, the location of the dominant cause prevails at the expense of the other subsidiary causes. In *Black's* case the taxpayer, who was resident and carrying on business as a stockbroker in partnership with others in Johannesburg, carried on a private business of speculating in shares quoted on the Johannesburg Stock Exchange. He also had an arrangement with a London firm of stockbrokers whereby the latter speculated on his behalf on the London Stock Exchange with moneys remitted to London by him and moneys advanced on interest by the London firm. Everything relating to the transactions was done in London except that, although the London firm was entitled to deal in shares on the taxpayer's account without his authorization, in the majority of cases transactions were only effected after confirmation or authorization by the taxpayer over the telephone. The court held that the source of the income from the London transactions was located in London.

Although the court did speak of looking for the 'dominant' or 'substantial' or 'real' or 'basic' cause of the income in determining its source, it is submitted that the use of these terms does not amount to a rejection of the principle of apportionment. First, the issue of

⁵³ *Supra* note 5 at 451.

⁵⁴ In ITC 77 (1927) 3 SATC 72 the Special Court for Hearing Income Tax Appeals authorized the apportionment of the source of income derived from services rendered.

⁵⁵ 1954 (3) SA 689 (A).

⁵⁶ At 700G-H. The question of apportionment was not canvassed in the majority judgment.

⁵⁷ 1957 (3) SA 536 (A).

apportionment was not raised by either of the parties nor was it even mentioned by the court. If the court had intended rejection of the principle of apportionment as a necessary concomitant of its test for source, one would expect this to have been made explicit and not left as an implication from the use of the terms referred to. Had the court intended rejection one would expect some reference to have been made to Watermeyer CJ's remarks on the question of apportionment in the *Lever Bros* case and to Schreiner JA's acceptance of apportionment in *Epstein's* case. In addition, the court did not find itself confronted with a situation in which there were two originating causes for the accrual of the amount in question, one located in South Africa and one in London, and therefore the issue did not arise. The court found that the originating cause was, in the alternative, either a distinct business in London of buying and selling shares or the use of the taxpayer's capital in London and the making and executing of the contracts in London.

In the *Transvaal Hide* case⁵⁸ the Botswana Court of Appeal referred with approval to the approach adopted in *Black's* case of looking for the 'dominant, or main or substantial or real and basic' cause of the accrual of income. It then proceeded to follow that approach. At the same time the court made it clear, as has been mentioned, that as apportionment was not an issue in the case it was unnecessary to consider it further. Thus Maisels JA said:

'On the facts of the present case, there would appear to be a good deal to be said for the view that the income should be apportioned between Botswana and South Africa; cp. the remarks of Schreiner JA in *Commissioner for Inland Revenue v Epstein*. . . . [T]he appellant in its objection to the assessments made no claim that the income should be apportioned, and it is limited to the grounds stated in its notice of objection. . . . No more, therefore, need be said on the question of apportionment.'⁵⁹

It is clear from the *Transvaal Hide* case that the court did not regard the approach of looking for the 'dominant, or main or substantial or real and basic' cause giving rise to an accrual as precluding the possibility of apportionment. On the contrary, it appears that if the appellant in the *Transvaal Hide* case had claimed an apportionment, Maisels JA, on the strength of his dictum quoted above, would probably have obliged.

It is submitted that there is nothing in the Act or in the case law to prevent a court, when confronted with the issue, from applying the principle of apportionment to source. It has been applied to expenditure and approved in the context of the deeming of income and, very recently, its application was extended to receipts and accruals in *Tuck's* case.⁶⁰ No valid objection exists for rejecting its further extension to source. No doubt the establishment of an acceptable

⁵⁸ Supra note 29.

⁵⁹ Supra note 29 at 224.

⁶⁰ Supra note 9 at 834D-I.

basis of apportionment may present difficulties in certain instances, but such problems are not confined to source. As Corbett JA said in *Tuck's* case:

'Having regard to the inherent nature of the receipt and its origin in the plan, it is not possible to find an arithmetical basis for apportionment . . . , but I do not think that this should constitute an insuperable obstacle.'⁶¹

V THE ONUS OF PROOF

In our view a taxpayer who contends that an amount received by or accrued to him should be apportioned either as between different sources or as between capital and revenue will have to raise this contention as a ground of objection in an objection to an income-tax assessment. This is because he will in any subsequent litigation be limited to his grounds of objection.⁶² Furthermore, a taxpayer who wishes to argue for an apportionment is required to set out a basis of apportionment in his objection.

The onus is on the taxpayer to prove that one of the *causae* giving rise to a receipt or accrual results in the conclusion that some portion of the amount is of a capital nature or is not from a source within the Republic.⁶³ Where the taxpayer contends that an apportionment of an amount is required, however, the question arises whether he bears the further onus of establishing an acceptable basis of apportionment.

It may be sufficient for the taxpayer to establish all of the facts surrounding the relative importance of individual *causae* and, having suggested his own apportionment, to leave it to the court to make its finding on the question of the exact apportionment to be applied. If the *causae* justifying an apportionment and their relative importance have been established by the taxpayer, the legal conclusion is that some apportionment must be made, and it is our contention that the court is required to make the apportionment it deems appropriate in the circumstances.

The approach suggested above accords, it is submitted, with that of Corbett JA in *Tuck's* case.⁶⁴

VI CONCLUSION

If what appears above is accepted as an accurate presentation of the current state of our income-tax law, then it is of fundamental importance to look to causation when determining whether the receipt or accrual of any particular amount constitutes gross income.

⁶¹ At 834J-835A. The willingness of the legislature to accept apportionment despite the difficulty it entails is illustrated by the Apportionment of Damages Act 34 of 1956. In terms of s 1(1)(a) of that Act the court is called upon to reduce the damages recoverable by a claimant to the extent which it considers just and equitable having regard to the degree in which the claimant was at fault in relation to the damage suffered.

⁶² Section 83(7)(b) of the Income Tax Act 58 of 1962. In the *Transvaal Hide* case *supra* note 29 Schreiner and Maisels JJA, while not ruling it out in principle, refused to consider apportionment for precisely this reason.

⁶³ Section 82 of the Act.

⁶⁴ *Supra* note 9.

Where two or more *causae* with differing tax consequences are found to exist, apportionment as between capital and revenue and as between different sources is not only competent but mandatory.

These conclusions, to borrow the terminology of Dershowitz quoted in the introduction, do not amount to grand conceptual breakthroughs, nor do they even move the law incrementally. The incremental movement of our income-tax law, to the extent that it has taken place, is the result of the efforts of our Appellate Division judges. To borrow again from Dershowitz, we hope only to gain points for having demonstrated that somebody else has already thought of the ideas propounded in this article.

WHAT NO LEGISLATURE CAN DO

'[I]t is beyond the power of the Courts, or of an Act of Parliament, to recall a day that has passed, or make a thing which has happened not have happened.

Non tamen irritum
Quodcunque retro est efficiet
(Hor. III. Carm. 29, 45).

That according to the writer is beyond the power of Omnipotence itself.
—per Maule J in *Mayor of Berwick v Oswald* (1854) 3 El & Bl 653 at 670, 118 ER 1286 at 1293.

(The lines from Horace read:

'Non tamen irritum
Quodcunque retro est efficiet; neque
Diffinget, infectum reddet,
Quod fugiens semel hora vexit.'

Translation by H T Riley in *Dictionary of Classical Quotations* (1909): 'Not Heaven itself will render ineffectual what is past, or annihilate and undo what the fleeting hour has once carried away with it.'

Translation by John Dryden (1631–1700):

'Not Heav'n itself upon the past has pow'r;
But what has been, has been, and I have had my hour.'

'The principle asserted is, that one legislature is competent to repeal any [A]ct which a former legislature was competent to pass; and that one legislature cannot abridge the powers of a succeeding legislature.

'The correctness of this principle, so far as respects general legislation, can never be controverted. But, if an act be done under a law, a succeeding legislature cannot undo it. The past cannot be recalled by the most absolute power': per Marshall CJ in *Fletcher v Peck* 6 Cranch 87 at 135, 3 L ed 162 at 177 (1810) (United States Supreme Court).

WHY WERE PSYCHIATRISTS INVENTED

'... Lord Justice Harman is reported to have recalled that in his youth "psychiatrists had not been invented" and that "no one was any the worse for it": Leader 'Expert Witness' *New Law Journal* 13 October 1966 p 1389 (vol 116 no 5255).