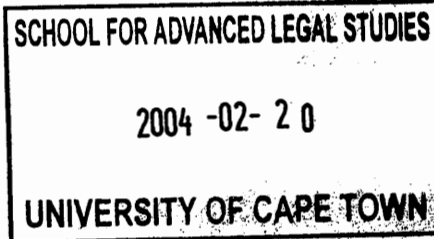


An analysis of paragraph (c) of the 'gross income' definition and the term 'services rendered.'

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I hereby declare that I have read and understood the regulations governing the submissions of Masters in Commercial Law dissertations, including those relating to length and plagiarism, as contained in the rules of this University, and that this dissertation conforms to those regulations.



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1. Introduction:

1.1 The South African Tax System

The South African tax system operates as a dual system of direct and indirect taxation. Direct taxation is imposed directly on taxpayers be they natural or legal by nature, by imposing tax on the income of those taxpayers. This is known as income tax. Another form of direct taxation is estate duty. By contrast, indirect taxation is where a transaction or consumption, rather than an entity is taxed. An example of this is VAT.

The South African Revenue Service currently imposes income tax on individuals, companies and other taxable entities. The legislation in terms of which income tax is imposed is the Income Tax Act 58 of 1962. The income Tax Act is an ever-changing piece of legislation, as each year it is amended to accommodate the changing economic environment as well as the tax proposals put forward by the Minister of Finance. §5 of the Income Tax Act governs the annual payment of tax according to the rates established at the beginning of each year of assessment. This is known as normal tax. The section indicates that tax can be levied against any person or company. The term 'person' is defined in §1 of the Act so as to include a deceased estate, an insolvent estate and a trust, and a company, in the same section, is defined to include a close corporation.

Normal tax is a levy that is determined according to the taxable income¹ of a taxpayer. The manner in which the taxable income of a taxpayer is determined, is by utilizing a specific methodology which has been formulated over the years and begins with the determination of the taxpayers gross income. Once that is established, it is reduced by subtracting the exempt income² of the taxpayer, leaving income. The final step in this calculation is to deduct the allowable deductions³, and to include any taxable capital gain or loss⁴ made in the year of assessment. What remains is the taxpayer's taxable income on which his/her tax is based. In the event that the allowable deductions should exceed the income of the taxpayer, the result is a loss, which can then, subject to certain rules, be carried forward to the following tax year. §1 of the Income Tax Act defines the terms "income" and "taxable income."

Income is defined as -

"the amount remaining of the gross income of any year for any period of assessment after deducting there from any amounts exempt from normal tax."

¹ See the definition of 'taxable income' below.

² This exempt income is stipulated in §10 of the Income Tax Act.

³ §11(a) and §23(g) when read together form the general deduction formula, which determines what amounts are deductible from a taxpayer's income. Also, there are specific allowable deductions stipulated in §11 - §20 of the Act.

⁴ Capital gains or losses made by the taxpayer in the year of assessment are included in the taxpayer's taxable income by virtue of S26(A) of the Act.

“Taxable Income” means the aggregate of-

- (a) the amount remaining after deducting from the income of any person all the amounts allowed under Part 1 of Chapter II to be deducted from or set off against such income; and
- (b) all amounts to be included or deemed to be included in the taxable income of any person in terms of this Act.”

As previously stated, the first step in determining what the taxable income of a taxpayer is, is determining what income received by the taxpayer constitutes ‘gross income’. Gross income is the total amount of the income received by the taxpayer, before the allowable deductions are taken into account.

The Income Tax Act 58 of 1962 defines gross income as follows:

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

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

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

The definition of 'gross income' then goes on to list certain specific inclusions through paragraphs (a) to (n), thereby ensuring that these amounts are included in a taxpayer's gross income, and taxed in his hands, even if they do not meet the definition of 'gross income'. An example of this would be if these amounts are of a capital nature. Silke points out, "it is expressly provided that the scope of the definition of the term gross income is not limited in anyway by the inclusion of these particular items. Therefore items that are not specifically included under parts (a) to (n) may nevertheless still fall within the definition."⁵ This means that paragraphs (a) to (n) do not form a numerous clauses and any amount can in fact fall into the taxpayer's gross income, whether it is capital or revenue in nature.

1.2 The specific inclusion of amounts received in respect of services rendered:

In terms of the specific inclusions listed, one of the most significant is paragraph (c), which provides that all amounts received in respect of services rendered or employment, whether capital or revenue in nature, are always included in the gross income of the taxpayer.

In previous Acts amounts received in respect of services rendered were included to a lesser extent than they are today. For instance, in Act No. 40 of 1925 s7(1) was the provision dealing with the definition of gross income. Paragraph (b) included in the taxpayer's gross income 'any amount so received or accrued in

⁵ De Koker A Silke on South African Income Tax Memorial Edition Butterworths 1995 pg4.4

respect of services rendered, whether due and payable under a contract of service or not.' This paragraph was not amended with the implementation of Act 31 of 1941, but in Act 58 of 1962 paragraph (b) was extended and is now paragraph (c) of the definition of 'gross income'.

Paragraph (c) includes in the gross income of the taxpayer:

Any amount, including any voluntary award, received or accrued in respect of services rendered or to be rendered, or any amount ... received or accrued in respect of or by virtue of any employment or the holding of any office: Provided that –

- (i) the provisions of this paragraph shall not apply in respect of any benefit or advantage in respect of which the provisions of paragraph (i) apply;
- (ii) any amount received by or accrued to or for the benefit of any person in respect of services rendered or to be rendered by any other person shall for the purposes of this definition be deemed to have been received by or to have accrued to the said other person;

Paragraph (c) was introduced into the Income Tax Act with effect on any year of assessment commencing on or after March 1985. What it effectively does is include in the gross income of the taxpayer any earned income or voluntary award included in the taxpayer's gross income in terms of services rendered or services to be rendered, or as previously stated, any amount received by virtue of the taxpayer's office held.

As illustrated by the wording of the paragraph, all payments made in respect of employment are to be included in a taxpayer's gross income. The courts have restricted the interpretation of the word employment, and it has been held⁶ that what needs to be considered is the extent of the control the employer has over the employee. It does not however, have to be a situation indicative of a master/servant relationship. Similarly the term 'the holding of office' has been interpreted by the courts to mean 'a position which generally carries with it some remuneration and "which is a substantive position, which has an existence independent of the person who fills it" and which will, in the ordinary course be filled by successive holders.'⁷

Thus it is clear that the contentious point is not in relation to payments made in respect of either the holding of office, or one's employment. Rather, an issue arises in determining whether or not a payment is made in respect of services rendered. Does that receipt or accrual, fall into the realm of gross income? Or, because that amount is of a capital nature does it fall outside the ambit of the definition?⁸ Paragraph (c) was included in the definition of 'gross income' with a view to overcoming this problem.

⁶ SIR v Somers Vine 1968 (2) SA 138 (A) at 154 B-C

⁷ Ibid. Ogilvie Thompson JA here adopted the meaning of the words given in the English courts, in the case of McMillan v Guest (1942) 1 All ER 606 (HL).

⁸ We assume that any other amount will be prima facie revenue in nature as it will be by virtue of employment or some similar situation.

As there is no definition of the term ‘services rendered’ in the Act, and the case law on the issue is decidedly inconclusive, how should that paragraph be interpreted, and in turn, how should it be applied? Thus, the aim is to consider paragraph (c) and try and determine, through examining the existing case law (albeit limited), whether guidelines have been established, indicative of what will and will not, constitute services rendered.

It is submitted that not all income received in this context should be viewed as potential ‘gross income’ in terms of the definition, particularly income that in many instances is received by chance. It is further submitted that an amount that is in some way connected to the services generally rendered by the taxpayer should be included in his gross income, and any income that is totally unrelated should be excluded. The challenge arises, in determining where that line is drawn.

1.3 Amounts specifically excluded from the ambit of paragraph (c):

It is important to note that certain amounts are specifically excluded from the ambit of paragraph (c). These are any amount received by the taxpayer in terms of s8 (1)⁹, and any benefit or advantage to which the provisions of paragraph (i) of the definition of gross income apply. Further excluded from inclusion in the taxpayer’s gross income are benefits that are taxable fringe benefits as received by the employee in terms of the Seventh Schedule of the Income Tax Act. These

fringe benefits although often in cash, are also often in kind. It has been suggested that the reason these amounts are covered by the Seventh Schedule rather than paragraph (c) is that the Seventh Schedule more strictly governs the valuation, inclusion and exclusion of these amounts, and therefore its provisions should rather be applied.

The Seventh Schedule governs special benefits that arise out of employment, and was included in the Act by the legislature in order to ring fence any benefit received by an employee in respect of their employment, and deem it to be a taxable benefit. This is achieved by paragraph (i) of the definition of 'gross income'. Paragraph (i) provides for the inclusion in a persons gross income of the cash equivalent as determined by the seventh schedule, of the value of a benefit during the year of a assessment granted to an employee in respect of employment that is a taxable benefit as defined in the Seventh Schedule. By contrast, paragraph (c) of the definition, deals with amounts received in cash, or benefits that can be converted into cash, and do not fall directly within the ambit of paragraph (i). Therefore it follows that any advantage that falls into the realm of paragraph (i) is excluded from the realm of paragraph (c). The result of this exclusion is that when a benefit is in fact a taxable benefit and gives rise to cash equivalent, the provisions of the Seventh Schedule in terms of valuation procedures will take preference over those of paragraph (c). Silke indicates that the error here is that the exclusion from paragraph (c) does not extend to the

⁹ Section 8(1) of the Income Tax Act covers advance payments that are made to the taxpayer in the relevant year of assessment. These payments are included in the taxable income of the taxpayer to

exclusion of benefits that are given a zero cash equivalent by the Seventh Schedule.¹⁰ The result is that although these benefits should effectively be tax free, as they are given a zero cash equivalent in terms of the Seventh Schedule, they have not been excluded from the realm of paragraph (c). Although it seems to be clear that this was not the intention of the legislature, these benefits may well fall into that realm of paragraph (c), and therefore become taxable by default. The legislature went into such detail in the wording of the Seventh Schedule, that it seems that any amount included here would be slotted in to the taxpayer's gross income by virtue of paragraph (i) and not by any other specific inclusions. If this were in fact the case, then on receipt of other amounts as covered by the specific inclusion/ exclusion clauses in the Act, the taxpayer would not be able to receive any of the advantages given in terms of the Seventh Schedule. Silke compounds the problem when he says that;

“...the problem would be overcome if the Seventh Schedule were viewed merely as a valuation regime establishing the values for tax purposes of certain non- cash rewards, leaving the resulting values to be included in gross income under the specific special inclusion. Regrettably however, the nexus between the Seventh Schedule and the definition of the term ‘gross income’ has been exclusively fixed by the legislature as paragraph (i).”¹¹

the extent that the taxpayer does not consume them during the tax year.

¹⁰ Silke on South African Income Tax

2. Interpretation:

It is trite that an amount received or accrued for services rendered falls within the general concept of income. Williams¹² points out that the words of paragraph (c) which precede its six provisos (except for the words ‘including any voluntary award’) are merely a statement of the above common law principle. He argues that although some courts have recognized this fact, for the most part the courts have ignored it.

In the case of *CIR v Delfos*¹³, Wessels CJ in commenting on the general rules of interpretation said that “in a taxing Act we are to give to a section a narrower or wider meaning than its apparent meaning, for in all cases of interpretation we must take the whole statute into consideration and so arrive at the true intention of the legislature.”

Another well-established rule is that in the event that there is an ambiguity in a taxing statute, the *contra fiscum* rule is to be applied and the statute is to be interpreted in favour of the taxpayer, in order that the taxpayer be subject to the smallest burden.¹⁴ Moreover, where there is no specific definition or interpretation of a phrase or word used in the Act, it must be given its ordinary meaning.

¹¹ Silke on South African income Tax Volume 1 pg. 4- 176

¹² Williams RC *Income Tax and Capital Gains Tax in South Africa: Law and Practice* Butterworths 2001

¹³ 1933 AD 242

¹⁴ *Glen Anil Development Corporation Ltd v SIR* 1975 (4) SA 715 (A)

Silke¹⁵ discusses MT Steyn's application of the new approach in *ITC 1384*¹⁶. MT Steyn first emphasized two principles that are of extreme importance when interpreting a statute. The primary aim when interpreting legislation is firstly to establish the intention of the legislator which can be done by examining the language used, and secondly, to bear in mind that unless it is clearly evident that the legislature was intending to be oppressive, it is presumed and interpreted to be as fair and reasonable as possible.

It is therefore important to look at the wording of a paragraph (c) in order to understand its meaning and intention.

3. The Meaning of Paragraph (c) of the definition of 'gross income':

Paragraph (c) uses much of the same language employed in the definition of 'gross income'. Therefore, words such as 'total amount', 'received or accrued' and 'in respect of' need to be looked at before phrases such as 'voluntary award' and 'services rendered' can be examined.

3.1 The interpretation of the word 'amount':

In the §1 definition of gross income, the word amount is given a wide meaning, and has been interpreted to mean income in cash or otherwise. It is clear that this therefore not only covers cash payments and remuneration but also

¹⁵ De Koker *Silke on South African Income Tax Memorial Edition 1995* Butterworths at 25-7

¹⁶ 46 SATC 95

includes any advances that an employee may receive by virtue of his employment from his employer, in order to enable the employee to carry out his obligations to his employer. These amounts are benefits that are prima facie fringe benefits but do not fall into the realm of paragraph (i). These amounts include benefits such as reimbursive allowances, travel allowances and subsistence allowances the value of which is determined by the Seventh Schedule. It is important to clarify that the term amount does not include any advantage obtained under paragraph (i) of the definition of gross income, nor does it apply to any amount referred to in the Seventh Schedule.

The true interpretation of this word for tax purposes was considered in the case of *Lategan v CIR*¹⁷. In his judgement, Watermeyer J stated that “ income is what a person earned by his work or his wits or the employment of his capital and that the rewards which such person gets may be in the form of cash or some other kind of corporeal property or in the form of rights”¹⁸. He continued to say that the legislature would never intend that the term amount have a narrow definition, and would therefore include not only cash as received but also the value of every form of property as earned by the taxpayer. This principle was further entrenched in the case of *CIR v People Stores (Walvis Bay) (Pty) Ltd*¹⁹. Here the appellate division widened the interpretation of the term amount, and confirmed that it need not be limited to money, but in order to qualify for inclusion in the “gross income” of a taxpayer, needs to be able to have a monetary value attached to it.

¹⁷ 1926 CPD 203

¹⁸ Ibid. Pg 208

This aspect was further illustrated in the case of *Stander v CIR*²⁰. The facts of this case were as follows: The taxpayer, employed as a bookkeeper by a franchise dealer, received a prize from the franchiser, in the form of an overseas trip. One of the aspects of this case that needed to be decided was whether the prize of an overseas trip constituted property. In other words, did the taxpayer acquire a right that could have a monetary value in his hands? The court found that the taxpayer could not have been said to have acquired a right, even if it could be converted into a monetary amount, and that no value could be placed on the trip that he had received. The court held that the taxpayer was “no more able to turn into money or money’s worth” the prize received by himself. It was not transferable by sale or by cession, and he could not exchange its value for something of equal value or cash.

Moreover, it is interesting to note that the whole amount received in respect of services rendered is taxable even though the party making the payment may not be able to deduct a whole or part of that amount as expenditure in the production of income.

3.2 The interpretation of the term ‘voluntary payment’:

The Act has been broadened so as to include in the ambit of paragraph (c) payments that are of a voluntary nature. The term voluntary indicates that the payment made does not have to be in respect of a contract or an obligation to

¹⁹ 1990 (2) SA 353 (A)

act²¹, and as long as it is rewarded in respect of services rendered, it is taxable in the hands of the taxpayer. Paragraph (d) of the Income Tax Act deals with voluntary payments made in respect of loss or termination of office. This paragraph would also cover a voluntary payment made to the partner of a deceased employee.

However, this paragraph would not cover voluntary payments made in respect of other personal circumstances an employee may be experiencing. These payments would also not be governed by paragraph (c). In order for payment to be governed by paragraph (c) it needs not only to be voluntary but also to be in respect of services rendered. It is submitted that SARS will distinguish between payments made in respect of personal circumstances and payments made in respect of services rendered.

The case of *CIR v Lunnon*²² dealt with the taxation of an amount paid to a taxpayer some months after the termination of his employment. In terms of the facts, there was no obligation on the company to make the payment and in fact, the payment was a gift in recognition of the taxpayer's services in previous years and as a solatium for the loss of his seat on the board of directors. Innes, CJ., held that this was not a payment as such and could therefore not be included in the taxpayer's taxable income. His reasoning was as follows. He stated that payment is in law the extinction of an obligation, and if there is no obligation, there can be

²⁰ 1997 (3) SA 617 (C)

²¹ ITC 689 16 SATC 501

no *solutio*. The taxpayer had no claim against the company, and they owed him nothing as he had been paid in full for his services on termination of his employment. In fact, all the essential elements for a donation were present, and the fact that the motive for the payment was gratitude for past services, did not alter the legal nature of the transaction. The lump sum payment was therefore a gift and as it was of purely capital nature, should not have been included in the taxable income of the taxpayer. This case served to enhance the common law so as to ensure that no payment received that was purely gratuitous in nature be taxable.

Williams²³ submits that the decision in this case was incorrect as at common law any quid pro quo received by the taxpayer for services rendered, whether voluntary or not, is income and therefore, taxable. He feels that it is irrelevant whether or not the amount received is a *solutio* for an *obligatio*, and goes on to quote Wessels JA in *De Villers v CIR*²⁴ where he said that it makes no difference whether an amount is paid as a gratuity, as a moral obligation or as a contractual obligation, if it is given in respect of services rendered, then it is taxable.

²² 1924 AD 94

²³ Williams RC *Income Tax and Capital Gains Tax in South Africa: Law and Practice* Butterworths, 2001

²⁴ 1949 AD 227 at 229

The legislature's response to the *Lunnon* judgement was to amend the definition of "gross income" so as to specifically include any voluntary award made for services rendered.

The general rule therefore, is that payments received for services rendered are of a revenue nature as they are fruits of labour. Therefore it is no longer the case that where a payment between an employer and employee is gratuitous in nature, it is automatically regarded as capital, unless, as previously indicated, specific circumstances arise. In the case of *Tuck v CIR*²⁵ the court held that where there is a receipt of payment by an employee, in order to determine the nature of the receipt, the reason for the amount being received must be determined. In this case, it was determined that the amount arose for two reasons: 50% of the quid pro quo received was for a restraint of trade payment and 50% was for services rendered. This resulted in the court using the apportionment principle and concluding that 50% of the amount was of a revenue nature (for services rendered) and 50% of the amount, of a capital nature (the restraint payment).

This loophole as now been sealed by the legislature with the implementation of paragraph (cA) which stipulates that any amount received by or accrued to a natural person, personal service company or labour broker as defined in the Fourth Schedule as compensation for a restraint of trade agreement forms part of that persons 'gross income' as defined and is therefore taxable in their hands.

²⁵ 1988 (3) SA 819 (A)

3.3 The meaning of the words ‘received or accrued’:

The definition of gross income specifies that in order for income to be taxed, it needs to be “received or accrued” by the taxpayer. Silke points out that despite colloquial references to the taxation of profits, what is included in the taxpayer’s gross income are receipts and accruals.²⁶ Without such receipt or accrual, the general rule is that there can be no liability for tax.²⁷ In the case of *CIR v Delfos*²⁸ the court held that the words ‘received by or accrued to’ effectively gave the Commissioner the right to levy tax on all amounts received by or accrued to the taxpayer in the year of assessment, whenever they had accrued and whenever they were to be received. It is important to note however, that an amount both received by and accrued to a taxpayer in the same year may not be taxed twice, and nor may it be taxed twice if accrued and received in two separate tax years.

The term “received” has now been clarified for the purposes of the definition of gross income. Goldstone JA in *Minister of Finance and Another v Law Society, Transvaal*²⁹ stated it well when he said that the words had been

²⁶ De Koker, *Silke on South African Income Tax* Memorial Edition 1995 Butterworths at 2.2

²⁷ There are certain instances whereby an amount will be taxable in the hands of a person whom that amount was not received by or to whom that amount did not accrue. An example would be in terms of s7 (2) of the Income Tax Act whereby a husband can be taxed on income received by his wife or s7 (5) and s7 (6) which provides circumstances whereby income received by or accrued to trustees or beneficiaries of a trust that is a result of a donation, is taxed in the hands of that donor.

²⁸ 1933 AD 242

²⁹ 1991 (4) SA 544 (A)

judicially interpreted to include income only received by the taxpayer for his own benefit and on his own behalf.³⁰

The court considered the principle laid down in the case of *Geldenhuis V CIR*,³¹ where it was decided that the word “received” means received for ones own benefit. The court held that although the appellant had received the proceeds from the sale of the sheep inherited by her from her late husbands estate, they were not received by her for her own benefit and therefore the amount received, could not be taxed in her hands. It is not necessary that a taxpayer receive a benefit from an amount prior to it being included in his or her gross income.³²

The term accrual is a little more complex, and after years of dispute was interpreted in the case of *CIR v People Stores (Walvis Bay) (Pty) Ltd*³³ to mean that when the taxpayer becomes unconditionally entitled to something, it has accrued to him, as opposed to ‘due and payable’ as it was previously thought. The court here referred to the Lategan Principle³⁴ which held that the words ‘accrued to’ meant ‘to which he has become entitled.’ From this it can be determined that once a taxpayer becomes entitled to an amount, that amount needs to be included in his/her taxable income. One major criticism is that if the words ‘accrued to’ mean ‘to become entitled to’ then the word ‘receipt’ becomes redundant.

³⁰ Income Tax Cases and Materials, Emslie, Davis, Hutton, Olivier; April 2001; The Taxpayer

³¹ 14 SATC 419

³² Ochberg v CIR 1931 AD 215

³³ 1990 (2) SA 353 (A)

³⁴ Lategan v CIR 1926 CPD 203

However, it is submitted that the word receipt means to have control of and be legally entitled to.

3.4 The interpretation of the phrase ‘in respect of’:

All payments received or accrued by the taxpayer need to be ‘in respect of’ services rendered in order to fall into the ambit of paragraph (c). The words “in respect of” can be interchanged with the phrases “by virtue of”, “because of”, “by reason of” or “owing to”. All these terms by virtue of their meaning suggest that there needs to be a direct link between the cause and the result, or a *causa causans*.

The term “in respect of services rendered” was considered in the case of *CIR v Transvaal Bookmakers Association*³⁵. This case dealt with the term as it then was in s7 (b) of the Act³⁶ where the learned judge held that because the words “in respect of” were used, rather than the word “for”, there is an indication that the payment may relate somewhat indirectly to the services, less directly than if the word “for” had been used. This seems to be a contrasting view to the following judgements, which, suggest that the words “in respect of” indicate the need for a direct link between the services rendered and the payment received.

In *ITC 1340*³⁷ the court considered the meaning of the term “in respect of” as used in s11bis (4)(f) of the Act.³⁸ The court held³⁹ that this expression may be

³⁵ 1953 (3) SA 203 (T)

³⁶ Income Tax Act 40 of 1925

³⁷ 43 SATC 210

used in many instances, but in each instance “ it is necessary to examine the context in order to ascertain the sense in which it is used.” Following that, the judge referred to the case of *Secretary for Inland Revenue v Wispeco Housing (Pty) Ltd*⁴⁰ where Ogilvie Thompspon said the following at 792:

“ No doubt the expression ‘in respect of’ must, in certain contexts, be restricted to a direct or causal relationship; but as was pointed out in *CIR v Butcher Bros (Pty) Ltd*⁴¹ the expression ‘in respect of’ does not necessarily or invariably indicate such a relationship. In that case it was held to be used in the sense of ‘in relation to’ or ‘in reference to’ the context wherein the expression [s] “in respect of and ‘in connection with’ is of vital importance. The true position was in my opinion, happily summarised by Shreiner JA, in *Rabinowitz and Another v De Beers Consolidated Mines Ltd and Another*⁴² at 631, as follows:

Expressions like ‘in respect of’ and ‘in connection with’, though they may sometimes be used to cover a wide range of association, must in other cases be limited to the close or more direct forms of association indicated by the context. ”

Similarly, the importance of the context in which this expression is used was highlighted in *ITC 1590*⁴³. The judge in this case held that there needs to be

³⁸ Income Tax Act 58 of 1962

³⁹ 43 SATC 210 at 212

⁴⁰ 1973 (1) SA 783 (A)

⁴¹ 1945 AD 301 at 320

⁴² 1958 (3) SA 619 (A)

⁴³ 57 SATC 160

some direct relationship between the advantage or benefit received by the taxpayer, and the employment or office of the taxpayer. In the case of *ST v COT*⁴⁴ the court held that the words “by virtue of” when given their ordinary meaning require that there be a direct link between the cause and the result.

The term “in respect of” indicates that there needs to be a causal relationship between the amount received and the services rendered. In the case of *De Villiers v CIR*⁴⁵ Stratford JA considered that the words “in respect of” had received judicial interpretation in the *CIR v Crown Mines* case.⁴⁶ In that case, Innes CJ said that tax could not be imposed “in respect of a particular subject matter unless it had a direct relationship to that matter”, Stratford JA interpreted that to mean that it is necessary for a causal relationship to exist. Whether or not this causal connection exists is a question of fact.

In *CIR v Stander*⁴⁷ the court reiterated the principle that in order for the prize as such to form part of the gross income of the taxpayer, it needed to have been earned in respect of services rendered. Friedman JP looked at the connection between the reward received by Stander and Delta (from whom it was received.) Stander did not work for Delta; rather, he worked for a dealer to whom Delta supplied vehicles. His receipt of the gift was by virtue of him working for Frank Vos Motors. However, the court held that the connection between his

⁴⁴ 935 SATC 99 at 100

⁴⁵ 1929 AD 227

⁴⁶ 1923 AD 121

⁴⁷ 1997 (3) SA 617 (C)

employment and the award received was not in itself sufficient to warrant taxation in terms of paragraph (c).

The court, in its reasoning considered the case of *ITC 701*.⁴⁸ The facts of that case were that the owner of a horse, who had won a race, had paid the horse's trainer an amount previously promised to him. Moreover, the trainer received a further amount from a punter who had won money after placing a bet on this particular horse. The court here held that the first amount, paid by the owner of the horse was subject to tax as it was related to services rendered by the trainer. The second amount, that from the grateful punter was not subject to tax, as it was incidental to the horse winning the race and not connected in any way to a service rendered by the trainer to the punter.

In *CIR v Stander*, the court held that there needs to be a causal link between the award received and the services performed, the services need to be the causa causans of the award. Friedman JP goes on to compare this case to the English case of *Moore v Griffiths*⁴⁹ where an English soccer captain received a sum of money as a bonus in respect of his team winning the World Cup. The judge in this case stated that the amount was received owing to the prestige of the event, the event being the world cup that was only held every four years and in respect of the fact that his team had won this prestigious event. The amount was not given to him in respect of services rendered.

⁴⁸ 17 SATC108

From the above, it can be determined that the term “in respect of” should be looked at contextually. In terms of paragraph (c) it is submitted that the term indicates the necessity of a close proximity between the income received and the reason for it being received. The words “in respect of” indicate that some kind of service needs to be rendered in order for the payment to be determined to be ‘by virtue thereof.’ There needs to be a causal connection between the two in order for paragraph (c) to come into effect.

Although it has been established that a causal connection needs to exist between the payment received and the services rendered, a possible question arises of how closely linked to the employment of the taxpayer does the service has to be?

*ITC 689*⁵⁰ dealt with the situation where a gift was given to the taxpayer as a token of appreciation for assistance rendered. The question considered by the court was whether the gift was a pure donation, in other words, one which is made out of pure liberality. The court felt that this was not the case, as the facts indicated that the promise of payment was made after a meeting in connection with a negotiation between the donor and two companies in which it was decided that the donor would lose his directorship of one of the companies. The appellant assisted the donor in that meeting, ensuring that he received adequate compensation for his loss of position. The court held the sum was paid in appreciation for assistance rendered (as stipulated by the appellant), and therefore

⁴⁹ 1972 3 All ER 399 at 411b-c

formed part of his taxable income. This case illustrates well that there is no need for the services rendered to be connected to the employment of the person rendering them, and therefore, any compensation received by a taxpayer for services rendered could fall into 'gross income' as defined. This was confirmed in the case of *H v COT*⁵¹ by Hathorn J where he stated that it is clear that the services being considered were not limited to those provided pursuant to an employment contract, and that the term "services rendered" should be given its ordinary meaning.

3.5 The meaning of the term 'services rendered':

So then the question remains, what falls into the term services rendered? When, in fact, has a service been rendered? and further, what guidelines exist, to assist in determining when a service has been rendered? Generally, paragraph (c) covers all forms of services rendered, and it has been established that the phrase is not limited to those services rendered only in terms of an employment contract, but can be extended to include any kind of service, including professional services and the services of a director. The true legal nature of the relationship between the parties needs to be looked at, in order to ensure that the payment made is related to specific services rendered. The courts have considered the term and how it should be interpreted.

⁵⁰ 16 SATC 501

⁵¹ 1957 (4) SA 478

In the case of *CIR v People Stores (Walvis Bay) (Pty) Ltd*⁵² the court considered the *Lategan*⁵³ judgment and quoted Watermeyer J, where he stated that ‘the definition of gross income does not seem to limit receipts of money in the year of assessments to such receipts as are the reward of work done or capital employed in the year of assessment.’⁵⁴ This therefore seems to include monies received not only by virtue of employment, but also by other means.

In terms of the words ‘services rendered’, it is important to distinguish between services rendered and the supply of goods, which inadvertently involves the provision of services. In *Millin v CIR*⁵⁵ Solomon CJ highlighted this distinction. He said that there is a difference between paying a person for his labour and paying him for an article, which he fashioned through his skill and labour. He uses the example of a carpenter hired to make a chair, who is paid per hour for the labour done. Here the carpenter is being paid for his labour, not the article produced. On the other hand, if the carpenter is commissioned to make a chair and a price is agreed upon, the carpenter is being paid for the thing he creates, not for the work he does. Pursuant to this reasoning, the decision in this case was that s9 (1)(b) of the Act⁵⁶ was applicable only to payments made for services rendered or work or labour done to order, and did not apply to an amount realised by the disposal of an article created by that labour.

⁵² 1990 (2) SA 353 (A)

⁵³ 1926 CPD 203

⁵⁴ at 207 - 210

⁵⁵ 1954 (2) SA 560 (A)

The term “services rendered” was further considered in the case of *Maseti v Key N.O and Others*.⁵⁷ Here, Herbenstein, J. held that the phrase ‘for services rendered’ is in common use and therefore its ordinary meaning should be determined. The learned judge established that the colloquial interpretation of the phrase is that something has been done for the benefit of some other person. In other words the supplying of a particular need. When one speaks of a fee received for services rendered, one means the payment of a sum of money as compensation for an act which has been performed, or a need which has been satisfied.”⁵⁸ This seems to be a broad and simplified interpretation, however the words “done for the benefit of some person” seem to encompass what the legislature is trying to achieve. Does this therefore indicate that any payment received for services rendered to another falls subject to tax? It seems that the definition needs to be narrower than that for the above implies that any service, regardless of necessary skill required or labour intensity that results in compensation being received, will fall into the realm of paragraph (c). To the point, in the case of *COT v Shein*,⁵⁹ Trengrove J held that “a man may render any services by accepting responsibility just as much by manual or by other work.”⁶⁰

The court here also considered the English case of *Blakiston v Cooper*⁶¹ which had decided that money given to a vicar as a farewell gift were “profits”

⁵⁶ Income Tax Act 40 of 1925

⁵⁷ 1951 (2) SA 187

⁵⁸ *Ibid.* at 192D

⁵⁹ 1958 (3) SA 14 (FC)

⁶⁰ 1958 (3) SA 14 (FC) at pg16

⁶¹ 1909 AC 104

accruing to him by reason of his office. The court here felt that “in each case it [is] a question of drawing the correct inference from all the circumstances of the payment and inferences drawn in other cases on different facts did not greatly assist.”⁶² From this dictum it can be seen that although there are often facts that are greatly similar in nature, in instances regarding the discussion of services rendered each set of facts needs to be looked at independently.

Further, it has been held that a payment received in relation to services rendered will always be taxable, even if received once the period of service has ended. In the case of *ITC 143*⁶³ the taxpayer, on termination of his employment, received a severance package inclusive of three months salary and a payment for the long service he had given the company. The commissioner included the full amount in the taxpayer’s gross income. The taxpayer appealed this inclusion on the grounds that one third of the payment received was not in respect of services rendered, but in respect of services over a long period. The court looked at s7 (1)(b) of the Act⁶⁴ and held that the expression ‘services rendered’ is not limited to services rendered in the period of taxation, but rather refers to the total period, long or short, of the service of the taxpayer.

Although the courts have tried to establish some limitation on the phrase ‘services rendered’, it seems that there is no set of principles by which it can be determined when a service has actually been rendered. In the following pages, I

⁶² Ibid. Pg. 88

⁶³ 4 SATC 220

will examine various instances where the courts have been called on to determine whether a payment received is in respect of services rendered, and in some instances to decide whether a service has in fact been rendered.

4. Cases where the courts have held the amount received was in respect of services rendered:

What follows are a wide variety of cases, dealing with different sets of facts which all held that the amount paid to the taxpayer was in respect of services rendered. In order to see that approach that the courts have taken, it is necessary to look at a number of cases, some of which now have specific legislation dealing with their particular circumstances. One of these is the issue of lump sum payments.

It is important to mention that although there is extensive case law⁶⁵ that includes in paragraph (c) lump sum payments received in respect of the termination of employment, the Income Tax Act was amended in 1986 so as to now include paragraph (d)⁶⁶ which specifically includes these payments in the taxpayer's gross income even though they are of a capital nature. Paragraph (d)

⁶⁴ Income Tax Act 40 of 1925

⁶⁵ The cases that dealt with this issue are: ITC 39 (2) SATC 790, ITC 1091 (28) SATC 224, R V COT (16) SATC 151, ITC 267 (7) SATC 156

⁶⁶ Paragraph (d) of the definition of 'gross income' includes in gross income of a taxpayer; any amount, including any voluntary award, received or accrued in respect of the relinquishment, termination, loss, termination, cancellation or variation of any office or employment or of any appointment (or right to claim to be appointed) to any office or employment: Provided that-

(i) the provisions of this paragraph shall not apply to any lump sum award from any pension fund, provident fund or retirement annuity fund;

will not apply to cases where the amount is paid to a person who is neither an employee or a holder of office.

One of these cases is *CIR v De Villiers*⁶⁷ where the term ‘services rendered’ was originally considered. This case considered circumstances whereby by virtue of retirement, the appellant became entitled to a cash payment in lieu of the leave that had accrued to him. In that year of assessment, the Commissioner included that amount in the taxpayer’s taxable income. The taxpayer objected to the inclusion on the grounds that the amount received was not taxable income, but rather a receipt of a capital nature.

The special court here held that the Commissioner’s decision to tax the amount was the correct one. The court felt that owing to the fact that the leave had accumulated by virtue of the services rendered by the employee, the payment made in lieu of that leave was taxable income in the ex-employee’s hands. This decision went on appeal to the Appellate Division (as it was then) where the court held that special court had decided correctly and therefore the payment was taxable income in the appellant’s hands.

(ii) any such amount which becomes payable in consequence of or following upon the death of any person shall be deemed to be an amount which accrued to such person immediately prior to his death;

⁶⁷ 4 SATC 86

In *Verinder Ltd v CIR*⁶⁸ the court held that a lump sum payment received on termination of a contract, as well as for services rendered in the past and loss of future profits, did fall into the definition of gross income and therefore was taxable.

In situations where a taxpayer is given additional income so as to cover his relocation costs, it has been held that the amount is received by the taxpayer in respect of services rendered, even though no services have yet been rendered. Further, in the event that the taxpayer becomes unable to render those services, that amount would not be recoverable by the employer.

There are two cases that clearly illustrate this point. Firstly, in the case of *CIR v Cowley*⁶⁹ the court held that a relocation cost fell squarely within in the definition of s7 (b) of the Act⁷⁰ as a payment for services to be rendered in the future. Further the court held that although there was no agreement as to the definite period of service between the parties, this did not affect the nature of the payment, which remained remuneration for that service.

Whether or not this is a just position is an academic debate unless it should again go before the courts. It seems to be an unfair burden on the taxpayer, as the additional finances given to him are to be used to enable him to relocate himself and his family. This money received is not in respect of any actual work done by

⁶⁸ 1949 (2) 147 (T)

⁶⁹ 23 SATC 276

the taxpayer, but rather a payment that allows him to relocate without incurring excessive cost. So in fact it could be compared to a payment that is used to incentivise a potential employee to take a position at a company. Although this is a payment that would only be made once, the trend of the case law indicates that it would be taxable as it would be received in respect of services rendered.

It is submitted that this income should be seen to be of a capital nature as it is a once-off payment that is only necessary once. Perhaps if the payment was being made on a continuous basis it would be more justifiable to deem it to be in respect of services rendered.

In the second case, *ITC 994*⁷¹ a German national entered into a contract of employment with a German company which had a controlling interest in South Africa. The contract stipulated that the employee would have to spend some time working in South Africa and therefore as part of his salary would receive an amount described as “an allowance for living apart from his family in Germany.” The reasoning behind the allowance was that the employee was married with children and the duration of his stay in South Africa was indeterminable. The allowance acted as both an inducement for the employee to accept the position and as a payment so that he could maintain both his home in Germany and his home in South Africa. The taxpayer was in South Africa for the duration of the 1954 to 1957 tax years, and in his determination of the taxpayer’s taxable income, the commissioner included that allowance that was received by the taxpayer and used for the maintenance of his German residence. The taxpayer objected to this

⁷⁰ Income Tax Act 31 of 1941

inclusion on the grounds that the amount did not constitute gross income in terms of §7(1) of the Act,⁷² or that he should be permitted a deduction on the grounds that the expenses incurred by him in Germany were in the production of income.

For our purposes it is only relevant to look at the court's response to the first line of objection. The judge in this case took note of the fact that this amount paid was received in German currency and that tax was paid on the amount in that country. However, the court found that the amount fell within §7(1) of the Act⁷³ and therefore fell within the taxpayer's gross income as it was received in respect of services rendered in South Africa, to a South African company in which the German company held a controlling interest. Here it appears to be more understandable that the income be included in taxpayer's gross income as it is not a payment made once, but a continuous payment. However, it is incorrect that the income be taxed twice and it is thus proposed that in the current taxation climate the courts would not be so hasty as to again tax that sum in South Africa.

In the case of *ITC 470*⁷⁴ the taxpayer was paid in addition to his salary, an amount termed a climatic allowance. This was owing to the fact that he was in an area where malaria was rife. This amount was included by the Commissioner in the taxpayer's gross income. The taxpayer objected to this inclusion on the grounds that the amount formed no part of his income. The court felt that it was difficult to distinguish between the monies he would have received had he been in

⁷¹ 25 SATC 134

⁷² Income Tax Act 31 of 1941

⁷³ Income Tax Act 31 of 1941

a place with no climatic difficulties and the money he did receive. The court held that the additional payment formed part of his salary and was therefore in relation to the services rendered by him in that area, and taxable.

From the above decisions it can be concluded that the courts will include in a taxpayer's gross income an amount that is paid over in addition to a salary as compensation for the loss of a comfortable and familiar home. It is also interesting here to see that each additional amount is related in some way to the employment of the taxpayer, and as yet there is no judgment that states that that is a factor which needs to be considered when determining whether an amount is in respect of services rendered.

An interesting issue to consider is the situation where information is given, and a reward is received. Assuming that there is no obligation to give information, is it justifiable for the revenue to tax a reward that is then given? Moreover, does the situation change if the giver of the information was aware that there was a reward offered and therefore the potential for money to be made? In this context, not only are situations where information that is given assist in solving a crime being considered, but also situations whereby the disclosing of information results in lucrative business dealings being formed. The question effectively becomes, has a service been rendered when information is voluntarily given?

⁷⁴ 11 SATC 263

There have been a number of cases dealing with a situation where a taxpayer is in possession of information which is potentially beneficial to another party, and as a result of passing on this information, is paid a reward or given a sum in lieu of thanks.

One such case that deals with this issue is the special court decision of *ITC 319*.⁷⁵ Here the taxpayer learnt that certain claims were about to become open for re-pegging, owing to the owner's inability to pay the costs connected to these claims. The taxpayer passed on this information to a promoter of companies on the understanding that should any profit flow from the information, he be entitled to a share. As a result of the information, shares were secured and the taxpayer was allotted a block of shares. The commissioner included in the taxpayer's assessment the value of the shares allotted to him. The appellant lodged objection to the inclusion on the grounds that the amount did not fall with s7 (1) of the definition of gross income in the Act.⁷⁶ The court held that the giving of information clearly fell under the definition of services rendered and the value of the shares received, was therefore taxable.

Similarly in *ITC 779*⁷⁷ the taxpayer became party to information relating to the sale of certain agencies by the propriety company and communicated such information to another company in which his wife held a substantial interest. Owing to the information given, the company acquired shares in the propriety

⁷⁵ 8 SATC 176

⁷⁶ In the Income Tax Act 40 of 1925 the definition of 'gross income' was encompassed in §7(1) of the Act.

⁷⁷ 19 SATC 326

company. In recognition of the information received, the company paid the taxpayer a sum that was reflected in its books as a cost to acquiring those shares. The taxpayer objected to the amount being included in his taxable income on the grounds that it was an accrual of a capital nature. The court looked at whether the services rendered in this instance fell within the meaning of 'services rendered' in this section,⁷⁸ and felt that the taxpayer had confirmed that it had by communicating his belief that he received the money because of the information he had passed on. The company had regarded that cost as a cost incurred in the acquisition of shares. The taxpayer had in fact gone out of his way to ensure that the managing director had heard that the shares were available for sale. The court felt that it was not causal information that he had passed on, and in fact his actions amounted to services rendered. The appeal was dismissed.

In the above cases, the situation appears to be that the taxpayer either expected to receive some type of gratuity for the passing on of the information, or was aware that his actions would result in some sort of remuneration. If one undertakes to act, or acts of his own free will but knows that he is more than likely to be compensated for his trouble, then perhaps the inclusion of that remuneration in his gross income is justifiable. What about situations whereby the taxpayer acts with a purely generous purpose, and inadvertently assists another resulting a payment being received by himself?

⁷⁸ s7(b) of Act 31 of 1941

In *ITC 938*⁷⁹ the taxpayer received a payment for facilitating an introduction between a potential purchaser and a seller of some fixed property. The taxpayer derived his income from farming and was in no way connected to the real estate business. He had no intention of seeking remuneration and in fact just passed on a name and address. The amount was included in the taxpayer's assessment by the commissioner. The taxpayer objected that it did not fall within §7(1) definition of gross income in the Act.⁸⁰ In his evidence the taxpayer indicated that not only was he surprised and embarrassed at having received the gratuitous sum but in fact, he hesitated about accepting it. The court said that regardless of what the taxpayer's intention was, in law a service had been rendered and therefore any monies received in respect of that service has to be included in the taxpayers gross income.

In direct contrast to the previous case, here is an absurd situation whereby the giving of a name and address were deemed to be a service rendered. It appears as if the courts here did not consider the taxpayer's views on the payment, as in the previous case, but rather felt that because the taxpayer had received some type of payment, he must have rendered a service. This judgment clearly illustrates the need for a set of guidelines determining what constitutes a 'service rendered'.

The most recent case dealing with the giving over of information and the term services rendered, is the Cape Provincial judgement of *CSARS v Kotze*⁸¹.

⁷⁹ 24 SATC 375

⁸⁰ Income Tax Act 40 of 1925

⁸¹ 64 SATC 447, 2002 (C)

This case was originally considered in the special tax court.⁸² The facts *in casu* were as follows: The taxpayer provided the police with information that led to the capture and conviction of foreigners involved in the illegal purchase of uncut diamonds. As a result of this information leading not only to an arrest but also to a conviction the Commissioner of Police exercised his discretion and rewarded the taxpayer with an amount of R200 000. The Commissioner for Inland Revenue included this income in the taxpayer's gross income in the 1993 year of assessment. The taxpayer objected and appealed to this inclusion on the grounds that the monies received were of a capital nature and therefore should not be included in his gross income, in terms of the §1 definition of 'gross income'.

It was established that the taxpayer's motive for going to the police was to protect himself from being implicated as being involved in the criminal activity, and to safeguard his reputation and business. At no time was he trying to get a reward, however, he did indicate that at all material times he knew that the police occasionally rewarded informants for information given.

In the court a quo, Hodas AJ President firstly looked at the relationship between the taxpayer and the police. He held that there was no employee/ employer relationship between the parties and therefore the amount did not fall into paragraph (i) of the 'gross income' definition, nor did it fall into the Seventh Schedule of the Income Tax Act.⁸³ Further, he went on to say that the amount would either fall into paragraph (c) definition of gross income or would be

⁸² ITC 1683 ITR 62 (2000)

completely excluded, and therefore tax-free. He then considered whether the amount did in fact fall into the ambit of the words “in respect of services rendered”.

The honourable justice divided this inquiry into 2 parts; firstly he considered whether the giving of information to the police could be deemed to be “services rendered” and if in fact this was the case, whether the reward of R200 000 was “in respect of” that service.

In determining whether or not the giving of information constituted a service, the court looked at *ITC 1359*⁸⁴. In this case a draughtsman had received a plot as a gift from the township promoter for whom the engineering company who employed him, had been working. The taxpayer sold the plot and received an amount of R8750. The question before the court here was whether that amount should be included in the taxpayer’s gross income. The taxpayer felt that because this amount was earned in respect of the plot, and the plot had been a gift, this amount was not subject to taxation.⁸⁵ The court here held that;

“the service need not be rendered by virtue of a contract between the person who makes the voluntary award and the recipient, nor need the

⁸³ *Stander v CIR* 1997 (3) SA 617 (C)

⁸⁴ 44 SATC 165

⁸⁵ It is submitted that the court erred in its finding here as what should have been included in the gross income of the taxpayer in that case was the value of the property, not the amount that it was subsequently sold for.

amount received or accrued be by reason of any contract or obligation. It can be a purely voluntary payment...”⁸⁶

Further the court referred to *ITC 1018*⁸⁷ whereby a director of a company had received an allocation of 250 fully paid for shares in respect of the loyalty and hard work he had contributed to the building of the business. The court found that comparatively in the present case, “the donation had not been made out of pure liberality, but in appreciation of services that had been rendered.”⁸⁸

The learned judge went on to say that the question of whether an amount has been received or accrued in respect of services, is one of fact and therefore, the test is whether there is a connection between the services rendered and the reward received.⁸⁹ Counsel for the appellant felt that the giving of information did not constitute “services rendered” as defined, for the following reasons. Firstly, because the taxpayer was only performing his civic duty by disclosing the information to the police, and secondly, because the act of giving information was not done for capital gain in any shape or form, but rather, so that the taxpayer could protect himself and his reputation from being soiled by criminal nuance. In fact, the true beneficiary of the taxpayer’s actions was himself, and it is impossible in law for one to “render a service” to oneself. Counsel’s argument here deconstructs itself, as one protecting ones reputation in the community is not

⁸⁶ 44 SATC 165 AT 166

⁸⁷ 25 SATC 409

⁸⁸ 44 SATC 165 AT 167

⁸⁹ CIR v Stander 1997 (3) SA 617 (C)

tantamount to one performing one's civic duty. The court found that the disclosure of information was in fact a service rendered by the taxpayer to the police.

The court then went on to look at whether the payment received, was in fact received "in respect of" services rendered. The court looked at the case of *CIR v Crown Mines*⁹⁰ in which this phrase was considered. In his judgement, Innes CJ stated that "a tax could not be imposed "in respect of a particular subject matter, unless it had a direct relationship to that matter" by which is meant, [a] causal relationship." The court found that

"the fact that the appellants disclosure of information to the police was a sine qua non of the receipt by him of the reward sought to be taxed, is not sufficient. For such disclosure to provide the necessary causal link with his obtaining the reward, the services rendered would have to be constituted the causa causans of the award."

With regards to the issue of causation, the court considered the decision *CIR v Shell Southern Africa Pension Fund*.⁹¹ In that case the court felt that the decision of a pension fund committee was an intervening factor that was completely independent and unconnected causative factor or event. As a result, that committee decision resulted in an intervening factor thereby breaking the causation chain.

⁹⁰ 1923 AD 12

⁹¹ 1984 (1) SA 672 (A)

In the current case, the court considered whether the disclosing of information was the causa causans of the receiving of the reward. The payment of a reward fell within the discretion of the Commissioner of Police, and therefore regardless of whether the information was useful to the police or not, the commissioner could have refused to pay the reward. The information however, led to both the arrest and conviction of the suspected criminals and it is clear that had this not happened the reward would not have been paid to the taxpayer. These factors were all causae sine qua non.

The decision of the Police Commissioner to give a reward to the taxpayer was, like the decision of the pension fund committee in the *Shell Southern African Pension Fund* case, supra, the “intervention of an independent, unconnected and extraneous causative factor or event”. This event, isolated the information given by the taxpayer from the receipt of the reward, and therefore, it could not be said that there was a sufficiently close causal connection between the information received and the reward given.

The majority of the court felt that the R200 000 reward received by the taxpayer should not have been included in his gross income, as it did not fall within the spectrum of paragraph (c) of the definition of gross income. The minority view of the court was that a distinction could be drawn between the present case and the *Shell Southern African Pension Fund* case. The accounting member of the court felt that in that case the death of the member was a historical fact that did not affect the decision of the pension fund committee. In the present case the fact

that the information led to the arrest and conviction of two criminals was a fact that led to the police commissioner exercising his discretion and granting a reward to the taxpayer. Therefore, he felt that the R200 000 was correctly included in the taxpayer's taxable income.

Davis J criticized this judgment prior to it going on appeal. He disagreed with the reasoning put forward by the court and said that the two discretionary decisions, that of the Police Commissioner and that of the pension fund committee were dissimilar. He distinguishes the former by indicating that there is a direct relationship between the reward received and the information given. The Police Commissioner having the discretion to decide whether the information is worthy of a reward, does not serve as a *sine qua non* between the information given and the reward received. He goes on to say that if the discretion becomes a possible *sine qua non* then no success will be had with paragraph (c) as all voluntary payments are by nature discretionary.

The Commissioner took the special court decision on appeal to the Cape Provincial Division. The judgement is reported as *CSARS v Kotze*.⁹² The respondent cross-appealed the decision of the court a quo as to whether the giving of information fell within the definition of services rendered. Davis J and Foxcroft J concurring, held that the special court had decided correctly as to the question of whether the provision of information fell within the ambit of the term 'services rendered'. At 449E of the judgement, the court states that;

⁹² 64 SATC 447 2002 (C)

“the respondent was not doing his civic duty like the person rescuing a drowning child as he was afraid of being implicated in suspicious activities and his motive, therefore, was to protect himself and that was not worthy of any kind of prize: the fact that he thereafter received payment which he did not give back shows conclusively that it had been received for the information which he had provided.”

The court further went on to agree with the minority view of the special court. They conceded that the reward was received after the Commissioner exercised his discretion, but, that discretion would not have been exercised had the information not been given. Therefore, they felt that the money was paid in respect of services rendered and found that the special court “had erred in holding that there was no sufficient link between the services rendered and the payment of the reward”.⁹³ The appeal by the Commissioner was accordingly allowed and the assessment for the 1993 tax year confirmed.

It is submitted that the court here erred in its decision, as although they held that the amount was in respect of the rendering of a service, the action was similar to the rendering of an honorable deed rather than an actual service. The taxpayer in this case was under no obligation to act and took it upon himself to go to the police and assist in an investigation. He had no vested interest in the situation and was in no way trying to obtain a monetary benefit for himself.

Further, it seems that it would be against public policy to tax payments of this nature. It is submitted that the court should have taken this opportunity to clarify the law on this issue and further should have laid down a principled approach which could be followed in future enquiries of this nature.

A case that dealt with the issue of the winning of prizes is *ITC 976*.⁹⁴ This case involved a writer who was both employed as a journalist and worked as a correspondent for other newspapers. In the year of assessment the taxpayer won both a playwriting and a poetry competition, and therefore, two amounts, of £500 and £600 in respect of a poetry competition and a playwriting competition respectively were included in his gross income.

The taxpayer objected to this inclusion on the grounds that they were fortuitous gain, and extraneous to his ordinary occupation as a journalist. In dealing with the amounts, the court looked at them separately. On the taxpayers own evidence it was found that although his occupation was that of a journalist, he had published two books of poetry and had been writing poetry for most of his life. Although the taxpayer had had no idea that there was a competition the fact was that writing poetry was part of his vocation and when the opportunity arose, he entered his poems into a competition with the object of making a gain from his labour of self expression. The court held that “the reward was so closely

⁹³ *Ibid.* 447I

⁹⁴ 24 SATC 818

connected to the use of his labour and wits as a writer of poetry that it constituted income in his hands.”⁹⁵

With regards to the play, the court felt similarly that although it was the first occasion on which the taxpayer had entered a play into a competition, he made a living from writing and therefore the prize money had to be treated as income in his hands.

Similarly in the case of *ITC 117*,⁹⁶ the taxpayer won a prize through his employment as an insurance agent. The prize was offered to the agent who during the year had insured the largest amount and secured the payment of the largest premiums. The taxpayer objected to the inclusion of the amount in his gross income on the grounds that it was a fortuitous gift and fell outside his normal remuneration for services. The court held that the prize was as a result of the wits and labour of the taxpayer and therefore fell within the same category as his income. Further, it is submitted that this kind of a payment is similar to a bonus payment and therefore would fall squarely within the definition of gross income.

In the above two cases, it can be seen that the prizes won were closely connected to the employment of the taxpayer. In the courts view, close enough to ensure that the payment received, in the form of prize money, fell within the definition of gross income. It seems logical that the money should then be included in his ‘gross income’. However, would the situation be the same if the

⁹⁵ Ibid. Pg.814

money was won in a competition that had no connection to his employment? Would that amount be deemed to be of a capital nature? Further, should that amount not be treated as a fortuitous and therefore not subject to tax? In the case of gambling for instance, gains received are not taxable unless the taxpayer is a professional gambler.

The question raised in the case of *ITC 430*⁹⁷ was whether a payment received for goodwill constituted a capital amount, or whether it was in respect of services rendered and therefore revenue in nature. The taxpayer in this case had suggested that certain business ideas be put into practice, and along with interested parties the relevant agreements were drawn up. The taxpayer had no previous experience in this field and the court felt that the conceiving of an idea did not warrant the goodwill asset.

The court felt that although the taxpayer *bona fide* believed that the remuneration received by him was in relation to goodwill, this did not override the terms of the agreement between the parties. The terms of that agreement were directed at providing payment to the parties who had rendered services in the creation and establishment of the business. Further, the contract stated that when the taxpayer received this amount, he should apply it to the issue to him of shares of a like nominal value in the company.

⁹⁶ 4 SATC 70

⁹⁷ 10 SATC 424

The court felt that although these two phrases were incorporated in the same agreement, they were in fact two separate agreements. The contract stated that the purchase price payable by the taxpayer to the company, for the issue to him of those said shares, would be set off against the company's liability to him. The agreement did not stipulate that the transactions should take place simultaneously, and therefore, the transactions were treated separately. The court stated that it was clear in the agreement that payment would be made in respect of services rendered, and therefore the amount formed part of the gross income of the taxpayer.

It appears from the above cases that the courts determine whether a service has been rendered on a case-by-case basis. As there is little precedent on the issue, and no guiding principles for the courts to follow, the result is often judgments without solid foundation. This serves to highlight the need for a set of principles by which actions can be measured against to determine whether they constitute services rendered or not.

5. **Cases where the courts have held the amount received was not in respect of services rendered:**

The cases that have held that an act does not constitute a service rendered are fewer, but no less relevant or indicative of the need for structure in this area.

An interesting and more recent case dealing with the issue of a lump sum payments is ITC 1386.⁹⁸ This case considered the situation where a lump sum payment in respect of a retirement annuity plan was paid to the widow of a

taxpayer. It was common cause that had the amount been paid to the employee while he was alive, it would have been taxed in his hands. The commissioner had taxed the amount in the hands of the widow, on the grounds that it fell within paragraph (c) of the definition of gross income, in §1 of the Income Tax Act as being a voluntary award for services rendered.

In coming to his decision, Malamet J considered the following important factors. Firstly, it was Escom's policy that payments of this nature were only made to persons whom the committee decided were worthy of the gratuity. The decision was left to the absolute discretion of the committee, and therefore, nothing was said or done by Escom to indicate to an employee that Escom would have a legal liability to payment to an employee or a widow of an employee. Bearing this in mind, it is clear that the issue at hand was whether the lump sum gratuity paid to the widow was revenue in nature or whether there was the necessary causal connection between the employment and the money received.

Melamet J, followed the dicta set out in the case of *SIR v Watermeyer*.⁹⁹ In that case, the court had held that because the payment was *ex gratia* from year to year, it lacked the annuality to be considered an annuity and therefore was not income as such, and not taxable in the hands of the widow. Further, the judge in that case went on to say that the payment made was unrelated to any services rendered by the widow.

⁹⁸ 46 SATC 116

Melamet J felt that no distinction could be drawn between that case and the present case, but did go on to say that in his opinion the correct interpretation of paragraph (c) would be that in order for income earned in respect of services rendered to be taxable, it has to be in the hands of the person who rendered those services, and in a situation where the recipient does not or will not render the services it cannot be said that the receipt of that income is in respect of services.

It is interesting to note that paragraph (d)(ii) of the Act now provides for any payment paid in consequence of the death of another to be deemed to have accrued to such person immediately prior to his death. This effectively erases the problem that faced the court in the previous case, as had that provision been in effect the amount would have been deemed to have accrued to the deceased immediately prior to his death.

Further, the case of ITC 1386¹⁰⁰ illustrates that regardless of whether the payment is discretionary or not, it is taxable, for it is not the circumstances that surround the payment that are important, but rather what it is in respect of. It has also been established that once-off payments as well as constant payments in respect of retirement do fall subject to tax. Moreover, should a company elect to make a payment to the widow of an ex-employee, that amount is not taxable in her hands as she is not the one who rendered these services. This is not to be confused with the situation whereby one person is rendering services and another

⁹⁹ 1965 (4) SA 431 (AD)

¹⁰⁰ 46 SATC 116

is benefiting from the income received in respect of those services as covered by paragraph (c)(ii) of the definition of 'gross income'. This aspect will be discussed in more detail further on.

An interesting query is one as to whether a fortuitous gain or windfall is subject to taxation. When considering this issue, the primary case to consider is the aforementioned case of *Stander v CIR*¹⁰¹. As previously indicated, the taxpayer, who worked as a bookkeeper for Frank Vos Motors (a franchisee), won from the franchise operator the prize of a seven-day overseas holiday for excellence in financial management. The court held that irrespective of what it had cost the company to provide the trip as a prize, the taxpayer was unable to convert the prize into money or money's worth. The court held that the prize received was not in respect of services rendered as set out in paragraph (c); and in fact the taxpayer's employment as a sine qua non of the receipt of the prize was not enough to qualify it as being 'in respect of service rendered.'

The *Stander* decision acts as confirmation that, apart from benefits that are taxable in terms of the Seventh Schedule, receipts and accruals that have no monetary value do not form part of the taxpayer's 'gross income' unless he is able to turn them into money.

¹⁰¹ 1997 (3) SA 617 (C)

In his article on the issue of prizes and income tax, Williams¹⁰² notes that if the taxpayer had been an employee of Delta, the prize would have been taxable in terms of the fringe benefit provisions of the Seventh Schedule, regardless of whether the prize was convertible into cash or not. He goes further, and says that had the employee been an independent contractor the prize would have fallen outside the realm of paragraph (c) and as the Seventh Schedule does not apply to independent contractors, outside that ambit too.

In contrast to the South African judgments, it is interesting to look at the position the courts have taken in Australia. In the case of *Scott v FCT*¹⁰³ a solicitor who had for many years acted on behalf of a particular client and had always been paid timeously and properly, was given as a gift a sum of £10 000. The court held that in terms of s26 (e) of the Income Tax and Social Services Contribution Assessment Act of 1936 to 1961 the income of a taxpayer who is engaged in any employment or the rendering of any services for remuneration includes the value to him of everything which he in fact gets whether in money or in kind or however it may be described, which is a product or incident of his employment or a reward for his services. The enactment does not bring to tax money or money's worth that is not income according to ordinary concepts.

The court here felt that the gift of \$10 000 was not in respect of services rendered. The judge said that all the circumstances surrounding the "gift" had to be considered. He said that an 'unsolicited gift does not... become part of the

¹⁰² Williams RC Prizes and Income Tax 1998 SALJ 430

income of the recipient merely because generosity was inspired by goodwill and the goodwill can be traced to gratitude engendered by some services rendered.’

Although this amount is not a prize received as such, it is a monetary gift and although the Australian court view it as being of a gratuitous nature, it seems contradictory that something so closely connected to the services generally provided by the recipient should be tax free.

This judgment can be compared to the South African case *ITC 1359*¹⁰⁴ as previously discussed. The court here said that in order for an amount to fall within the ambit of the words ‘services rendered’, it need not have been awarded by virtue of a contract or obligation. It can be purely voluntary. It is therefore submitted that in terms of the current South African tax legislation a payment of this nature would be deemed to be income in respect of services rendered. Had the solicitor in the previous case not done extensive work for the client over a long period of time, he never would have been privy to such a gift.

In *KBI v Snyman en Webster*¹⁰⁵ a contract was entered into for the sale of goodwill. Goodwill here was interpreted by the court a quo to mean ‘drawing power’. The facts indicate, that these were two well-known second hand car salesmen, who had built up goodwill in their names and reputations. An amount of R100 000 was credited to the taxpayer’s loan accounts in respect of the

¹⁰³ 1966 (117) CLR 514

¹⁰⁴ 44 SATC 165

goodwill, and the question arose whether this amount formed part of their gross income.

The court held that the consideration received by the sellers was in relation to their drawing power and in no way related to the knowledge they had of the company. The judge here felt that this sale did not fall within the wording of paragraph (c), as it was distinguishable from services rendered by them to the company both in the past and in the future.

It seems that the courts are unwilling to allow a payment for goodwill to be termed as being part of services rendered. However, in a situation where an employee is drawn from company to another, and a portion of his salary is based on the fact that he has an excellent reputation and clients trust him, is that portion not effectively for goodwill? Or does it just form part of his salary? Would the situation be any different if, an employee was headhunted by one company from another, and his clients followed him? Under those circumstances would a portion of his salary be attributed to his goodwill? And if the courts have been reluctant to include it in 'gross income' in the past, would they now amend their position?

It seems however, that the position remains that the term 'services rendered' indicates a need for a close connection between what is actually done and the payment received. Although there have been many cases dealing with

¹⁰⁵ 56 SATC 149

various scenarios looking at whether services have been rendered or not, there are, as previously stated, no clear definitive guidelines to follow.

It therefore appears that our courts will include any amount that is directly connected to a person's employment and can be converted into a monetary amount, into the gross income of that person. It seems that little regard is given for the circumstances surrounding that payment and the current test seems to be the closeness of the connection between the money received and the taxpayer's employment.

6. Consideration of paragraph (c)(ii):

It is important to consider paragraph (c)(ii) of the 'gross income' definition for it deals with a different manner in which income could be received. In contrast to the first part of paragraph (c), it deals with situations whereby an office holder cannot give to any other taxpayer rewards received by himself for services rendered. This means that monies received by a person for services rendered by himself cannot be endorsed over to another who did not actually render the services. In other words, regardless of who may receive or be entitled to the rewards received for those services, the provider of those services is under obligation to pay tax on the consideration received for them.

It would then seem that in a situation where an employee is asked to represent his employer on a committee for instance, and the contract stipulates that each committee member is to be paid on the day of sitting, the employee would appear to be subject to tax on that income. Prima facie it seems this relationship is one of principal and agent and therefore any payment the employee receives is received on behalf of the employer. This situation seems to be the one that is covered by paragraph (c) (ii). Silke¹⁰⁶ mentions a similar situation where a natural person is nominated by his employer to act as a director of a company in which the employee is a shareholder and the fees payable to the director, are per the contract either payable directly to him or to the natural person who then is obligated to hand them over. Silke mentions that SARS in Practice Note 4¹⁰⁷, has accepted that in this situation paragraph (c) (ii) does not apply. This scenario is similar to the previous one, but for the fact that in the first scenario the legislature requires the director and not his employer to be liable for the tax.

In the recent case of *CSARS v Professional Contract Administration CC*¹⁰⁸ the court considered a situation whereby a close corporation retained the services of its sole member to render services to a third party. The commissioner, relying on paragraph (c)(ii), deemed the income received by the close corporation to be part of its sole members gross income on the grounds that the services had actually been rendered by that member and therefore the monies had accrued to him.

¹⁰⁶ Pg 4 -177

¹⁰⁷ 2 September 1985

¹⁰⁸ 64 SATC 119

The court held that the contract between the close corporation and the third party reflected the true intentions of the parties. Moreover, a taxpayer is allowed to arrange his affairs in the most tax efficient manner, and it was clearly advantageous for the sole member in these circumstances to run his business through a close corporation. The court highlighted the point that the contract was indicative of the fact that the third party had contracted with an independent contractor and not an employee, despite the fact that the payment received from this particular third party was the only income received by the close corporation in that tax year. In response to this the commissioner stated that the contract between the third party and the close corporation was in fact one between the third party and the sole member and it was therefore necessary to pierce the corporate veil. The court said that the assertion by the commissioner that whenever a sole member of a close corporation renders a service on behalf of the close corporation, he is actually rendering it in his personal capacity is illogical and ignorant of the practicalities of modern life.

The court in this regard considered a case with similar facts, *ITC 1618*.¹⁰⁹ Here the commissioner had similarly contended that at all material times the services were rendered by the sole member of the close corporation, and not the corporation itself, and therefore, the simple act of incorporation did not disguise the fact that the member had rendered the services. The judge president in this decision referred to the Appellate division case of *Erf 3183/1 Ladysmith (Pty)*

¹⁰⁹ 59 SATC 290

*Ltd & another v CIR*¹¹⁰ where Hefer JA said that a party may arrange his affairs to so as to remain outside the ambit of specific legislation and, that the courts will not have the wool pulled over their eyes in respect of simulated or disguised transactions, but will pierce the corporate veil and expose the true nature and substance of an agreement. The learned judge went on to say that a transaction is not necessarily disguised just because it is formulated for the purpose of gaining a tax benefit. Therefore, if there is a real intention by a businessman to set up a corporation and have it earn income, then the court will give effect to that intention. The judge president therefore decided that the sole member in that case had given an acceptable explanation as to why he conducted his business through a close corporation and therefore, there was no simulated or disguised transaction.

Taking the above into consideration, the court in the present case held that paragraph (c)(ii) could not simply be applied where a member of a close corporation rendered a service, but in fact could only be applied where the substance of the contract is indicative of the fact that the member of the close corporation and not the corporation itself is the one rendering the services. This application of the section further substantiates the interpretation of paragraph (c)(ii) that no matter who receives the reward, the person rendering the service will be liable for the tax.

¹¹⁰ 1920 AD 530 at 547

The case of *ITC 1759*¹¹¹ concerned three separate trusts in three separate cases, dealing with the same set of facts and legal principles in dispute between themselves and the Commissioner. The court here considered whether management fees received by the trust were correctly taxed by the commissioner in the hands of the trustee in terms of paragraph (c)(ii) of the definition of gross income. The appellants objected to this taxation on the grounds that the management services were rendered by the trust in law, acting through the trustee, and therefore it was unwarranted to tax the trustee personally, as the services that were rendered had been rendered by the trust. There was evidence before the courts illustrating that the trustee had received separate cheques on behalf of the trust and had endorsed these cheques to the trusts. There was nothing to indicate that these cheques be for anything other than the benefit of the trusts. The question before the court was therefore, who rendered the services to the trust, the trustee in his personal capacity or the trustee as he was, acting on behalf of the trusts?

The learned judge held that the managerial fees had been rendered on behalf of the trusts, as they jointly owned 50% of the shares in a hotel. The services that were rendered by them, via the trustee, were compensated for. The judge went on to say that there was nothing in the evidence to indicate that any of the services rendered by the trustee were done so in his personal capacity and therefore the management fees in issue should be taxed in the hands of the trusts.

¹¹¹ 65 SATC 439

Considered in the above case was the case of *ITC 1518*¹¹² where taxpaying companies were paying management fees to two trusts in respect of managerial services being rendered on behalf of the companies. The taxpayers performed farming operations in three different capacities, as employees of the farm through a partnership by the companies, as directors of the companies which owned assets of the trust, and as trustees of the trust, being the shareholders in the companies and which were obligated to perform certain management services. The taxpayers received salaries for the services they performed as part of the partnership, the services they performed as directors and the services performed on behalf of the trust. In terms of the agreement with the companies, the remuneration received for managerial functions was market related. The evidence put before the court was indicative of the fact that the managerial activity was only happening very late at night or early in the morning, but the remuneration being received was almost double that of the director's fees and one and a half times what was paid for supervision of the farm.

The court in this case found that the amount paid to trustees in relation to the managerial services performed was excessive. The taxpayers were able to negotiate with the Commissioner as to what was a reasonable remuneration and what should be added back to their taxable income. The court came to this conclusion by virtue of paragraph (c)(ii) "as the managerial remuneration paid to

¹¹² 54 SATC 113

the trust resulted in the activities of the taxpayers motivating the liability for such tax.”¹¹³

Further, it seems that a taxpayer is not able to determine how much is enough in respect of services rendered. In the case of *Director v COT*¹¹⁴ the court held that a taxpayer may not claim that he has received a payment in excess of his worth. The court here referred to the New Zealand case of *Aspro Ltd V The Commissioner of Taxes*¹¹⁵ where it was held that in circumstances where salaries paid to directors are excessive, they can be disallowed to the extent they are excessive, on condition that they are not actually incurred in the production of income. The court here went on to say that although this decision had been followed in South Africa there was no authority for the converse, that is where the recipient of the income is entitled to claim that portion of it be disallowed as being excessive and he be taxed on the balance.

From the above decisions it can be seen that paragraph (c)(ii) was included in the Act to close a loophole that enabled a taxpayer to perform services and earn, but not pay the taxes on those earnings as they were being distributed to another person or entity. The main issue here seems to be that taxpayers are setting up close corporations of which they are the only member and then allowing the income earned to be taxed in the hands of the entity. The courts and the legislature indicate that the remuneration received for services rendered needs to be taxed in the hands of the person rendering the service. Although a taxpayer

¹¹³ 65 SATC 439 at 444

¹¹⁴ 16 SATC 146

is entitled to organize his affairs in the most tax efficient manner, it is that the current situation will continue indefinitely. However, it is interesting to note that in *COT v Shein*¹¹⁶ the court held that accepting responsibility constituted rendering a service and therefore the service would be where the responsibility was exercised. This could be interpreted to mean that if a close corporation undertakes to render a service, they are accepting that responsibility for rendering the service, and therefore the payment received should be taxed in their hands.

7. **Conclusion:**

It can be concluded from the above discussion that there is in fact little by way of guidelines in attempting to determine the meaning of the phrase 'services rendered.' It appears that the only solid indication that an amount received should be included in a taxpayer's gross income is, as was confirmed by *Stander*, if a close enough connection can be made between it and the service rendered. However, the argument turns into itself, because there is still no solid test to establish when in fact a service has been rendered.

Cases that have held that an amount should be included in the 'gross income' of a taxpayer often connect the service rendered by the taxpayer to the taxpayer's employment¹¹⁷ and include amounts that are often paid in addition to the taxpayer's salary. Further, the cases seem to indicate that where there is an understanding that some type of payment is to be received, it is indicative of the

¹¹⁵ 1932 A.C 683

¹¹⁶ 1958 (FC)

fact that a service is going to be rendered. Moreover, the attitude of the both the payer and the payee seem to have an effect on whether the court deem a service to have been rendered.

It has been said “that the originating cause of income from services rendered or work done are the services or the work, as the case may be, whether they are mental or physical, and whether they are rendered or done in person or through the agency of another.”¹¹⁸ Perhaps because then, owing to the width of the phrase, the courts have taken the correct approach by deciding things on a case-by-case basis, considering every set of facts independently.

In light of this, perhaps it would be easier to determine that any amount received (other than those referred to in the Seventh Schedule) even remotely connected to ones area of employment or skill, should fall into this special inclusion, and any other amount received by a taxpayer should be deemed to be of a capital nature and therefore exempt from taxation.

Lord Cairns in the case of *Partington v The Attorney General*,¹¹⁹ a case often quoted in the South African Courts said that

“if the person sought to be taxed comes within the letter of the law, he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the

¹¹⁷ CIR v Cowley, ITC 994, ITC 470, ITC 976, ITC 117.

¹¹⁸ Meyerowitz on Income Tax pg 7-13

subject within the letter of the law, the subject is free, however apparently within the law the case might otherwise appear to be.”

It seems in this instance, that there is no letter of the law which can be safely followed, and therefore, it is necessary for the courts to establish a set of principles which can be followed when trying to determine what falls into the ambit of the words ‘services rendered.’

¹¹⁹ 21 LT 370 at 375

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