Personal Injury Awards: The impact of income tax on damages for loss of earning capacity.

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INDEX

1. PROLEGOMENON

It is a vexed question internationally whether, in personal injury actions, damages are awarded for lost earnings or lost earning capacity. As will be more fully discussed in due course, both the case law and the general practice of the courts are inconsistent, with wholesale acceptance of either "concept", and both judges and academic writers are guilty of indiscriminate use of both terms whilst espousing support for one or other concept.

It will be submitted that the South African authorities favour the concept of loss of earning capacity, in line with the international trend. Whether or not this distinction should or does have practical implications will be considered and debated. Given, however, the inconsistency mentioned above, the writer will be unable to make reference to only one or other of the generally accepted terms and the reader is accordingly requested to bear this in mind.

2. INTRODUCTION

As Luntz[1] observes, the question as to whether a court should use, as a basis for the assessment of damages for loss of earning capacity, the plaintiff's earnings before or after tax has been one of the most

controversial in/....

controversial in the whole law of damages for personal injury. Courts in different jurisdictions have reached contrary conclusions and the High Court of Australia, for instance, itself turned a remarkable somersault within a very short space of time.

Surprisingly, the issue itself does not seem to have been raised in court until approximately the middle of this century. Luntz[2] ascribes this to the relative insignificance of income tax in earlier years. A reason for its emergence as an issue may also be the growing trend towards the particularisation of heads of damages, and the move away from awarding globular sums.

In South Africa the proper treatment of taxation in the context of damages for lost income has presented some difficulty for the courts, and despite hovering in the background for decades, no clear solution has yet emerged. As Boberg[3] puts it: "And so it is on this uncertain basis - the provincial courts apparently at odds with the Appellate Division - that matters stand in South African law today".

The fairly recent appellate division decision in KBI en 'n ander v Hogan[4], whilst dealing primarily with the question of whether payments in terms of S21(1C)(b) of the Compulsory Motor Vehicles Insurance Act[5] constituted an annuity and are therefore subject to income tax, has encouraged a renewed debate[6]. When the amendment of the Act was effected by the

insertion of/....

insertion of S21(1C), which marked the departure "from the common-law principle of a singular cause or right of action for all compensation for past and future loss or damage and substituted for the latter the statutory principle of its being sufficient unto the day if and when the claimant has to pay."[7], Boberg[8] foresaw the urgent need to adopt one course or the other i.e. to either take into account the income tax which would have been payable on the lost future earnings or ignore it, when calculating an award. For without such a decision, the anomalous situation may arise that a plaintiff's fiscal fortunes would depend on whether or not his claim is governed by the statute.

The emphasis in this paper will be on actions in respect of personal injuries. Attention will be paid to international and South African judicial and academic treatment of the problem. Because the problem raises considerations of policy and principle, the purpose of compensation and principles underlying taxation will be examined. Finally, some suggestions and proposals towards a solution will be discussed.

3. THE RULE IN GOURLEY'S CASE

Until the decision in British Transport Commission v Gourley[1], the English Courts had not reduced awards of damages on the grounds that the amount, for the loss of which the damages represented compensation,

would have/....

would have been diminished in the plaintiff's hands by the incidence of taxation[2]. In this case, however, the House of Lords held that, in a delictual action for damages for personal injuries, the calculation of the plaintiff's damages in respect of his loss of earnings, both past and prospective at the time of trial, must take into account the tax which would have been payable on them, thus overruling the earlier cases to the contrary.

The plaintiff in Gourley's case was an eminent civil engineer who had been seriously injured in a railway accident. Although he was able to resume work, his earnings were and would continue to be much reduced. Inasmuch as the Defendants conceded the merits and admitted liability, the main issue was whether in assessing the damages to be awarded to the plaintiff the court should take into account the income tax and surtax which the plaintiff would have had to pay on the earnings. Pearce J., bound by the decision of the Court of Appeal in Billingham v Hughes[3] ignored the incidence of tax and awarded Gourley £37,720 in respect of his loss of earnings. The Court of Appeal, likewise bound, affirmed the award. At the request of the Defendants, Pearce J. made an alternative assessment of damages for loss of earnings upon the basis that the tax should be taken into account and arrived at a figure of £6,695. The House of Lords, by a majority (Lord Keith dissenting), held that tax should be taken into account and that the assessment of £6,695 was the correct figure for loss of earnings.

Earl Jowitt, who delivered the leading speech, said[4]:

> "The problem is . . . . for what damages is he" (a wrongdoer) "liable? And if we apply the dominant rule, we should answer: 'He is liable for such damages as, by reason of his wrongdoing, the plaintiff has sustained.' . . . . My Lords, I agree with Lord Sorn in thinking that to ignore the tax element at the present day would be to act in a manner which is out of touch with reality. Nor can I regard the tax element as so remote that it should be disregarded in assessing damages. The obligation to pay tax - save for those in possession of exiguous incomes - is almost universal in its application. That obligation is ever present in the minds of those who are called upon to pay taxes, and no sensible person any longer regards the net earnings from his trade or profession as the equivalent of his available income. Indeed, save for the fact that in many cases - though by no means in all cases - the tax only becomes payable after the money has been received, there is, I think, no element of remoteness or uncertainty about its incidence . . . . I see no reason why in this case we should depart from the dominant rule or why the respondent should not have his damages assessed upon the basis of what he has really lost, and I consider that in determining what he has really lost the judge ought to have considered the tax liability of the respondent."

It should/....

It should be noted that it was agreed by counsel[5] in Gourley's case that no tax would be payable on the damages themselves, and the decision of the House of Lords was made on that basis. Earl Jowitt believed the agreement was rightly made[6]. Thus two factors were present which enabled the court to reach their decision: (1) the sums for the loss of which the damages awarded constituted compensation would have been subject to tax; and (2) the damages awarded to the plaintiff would not themselves be subject to tax[7].

Lord Keith, in his dissent, expressed certain concerns with the decision of the majority:

(i) he deemed it anomalous that in a situation where two hypothetical plaintiffs with equal earnings, but where one had in addition income from investments or a wife with an income and the other is single with independent income, and where both plaintiffs are injured in the same accident and disabled for life, the plaintiff with the independent income would possibly be awarded less, where he was in a higher tax bracket, i.e. it would result in inequity between comparable cases;

(ii) the decision would give rise to serious difficulties and complications, not necessarily confined to British Tax Law (for instance, where a foreigner was injured in Britain), in assessing a plaintiff's financial position and the tax implications thereof;

(iii) if an/....

(iii) if an award of damages for loss of earnings is not subject to tax, to deduct tax before assessing damages would be to exercise taxing powers in an indirect way:

> "If there is a case for thinking that assessing damages on a basis of gross earnings in actions for personal injuries, or for wrongful dismissal, enables the individual to escape his fair contribution to the national revenue, the position, in my opinion, should be rectified by legislation."[8]

Before examining how other jurisdictions have dealt with this problem, consideration will be given to some of the arguments for and against the Gourley principle.

3.1 Arguments for the Gourley Principle

Dworkin[9] describes the arguments which persuaded the majority of the House of Lords to find as they did as "few but compelling" and "variations on one theme"[10].

3.1.1 The Compensation Principle

Whilst the principle of restitutio in integrum may be inappropriate

where the/....

where the damage is incapable of being measured in financial terms, where a person suffers financial loss as the result of an unlawful injury to him the "dominant rule of law" is that of compensation. Thus the plaintiff is entitled to be awarded such sum as will, as far as possible, make good to him the financial loss which he has suffered and probably will suffer, as a result of the wrong done to him for which the defendant is responsible. Gourley emphasises this sound principle. However, compensation can rarely be accurate or complete, some losses being necessarily ignored, and in itself it does not solve the problem.

3.1.2 <u>One must be realistic and therefore tax cannot be too remote</u>

As Dworkin[11] concedes, it is unrealistic to ignore the impact of taxation upon a person's financial position, but this of course begs the question. The question of remoteness in the law of damages is often a question of policy disguised by phrases such as "reasonably foreseeable", "matters completely collateral", "collateral benefits", and "res inter alios acta". The anomalous situation thus arises that whilst a sum received by a plaintiff in respect of accident insurance is not applied in reduction of the damages awarded to him, insurance being as realistic a feature of modern society as tax, the incidence of tax is taken into account, if following Gourley. It is thus submitted that this reasoning is a matter of policy rather than a

conclusion of/....

conclusion of logic.

3.1.3 Overcompensation

Succinctly put, a plaintiff ought not to be placed in a better position than he would have been had the wrongful act not occurred. Whilst a cogent argument, because of the principle of collateral benefits, it may often be so that the plaintiff is "overcompensated".

3.2 Arguments against the Gourley Principle

3.2.1 Remoteness

Simply the flip side of the aforementioned policy decision. Its proponents argue that taxation is res inter alios acta.

3.2.2 Complexity

Described by some as the strongest argument against Gourley. The simple rule of ignoring tax which applied for generations is superseded by a rule which creates serious difficulties in practice, some of which are set out below.

3.2.3 Does Gourley apply?

To apply/....

To apply Gourley, one has to determine whether the award will be taxable in the plaintiff's hands. It would appear that there has been relatively little judicial examination of the taxability of damages. What is clear, is that a decision of a Court in an action for damages will not bind the Revenue, thus making it possible that a plaintiff is taxed twice, first when the damages are calculated, and thereafter when the award is made and Revenue successfully maintains the sum received to be taxable.

If the decision by Revenue not to assess certain damages is a matter of practice rather than law, the sum which a defendant is ordered to pay depends upon the administrative discretion of a third party - not a satisfactory state of affairs.

3.2.4 Inaccuracy

It is obviously not possible to predict accurately the future level of taxation over a number of years. Earl Jowitt in Gourley[12] dismissed this consideration, noting that "it is impossible to assess with mathematical accuracy, the amount of damages which should be awarded for the injury itself and for the pain and suffering endured." Similarly, it is often difficult to predict accurately what the earnings themselves are likely to have been. However, critics[13] of this approach point out that had the trial in Gourley

been postponed/....

been postponed for two years, the plaintiff would have received several thousand pounds more by way of damages as a result of downward changes in the standard rate of income tax.

3.2.5 Future Planning

A plaintiff awarded a net sum is deprived of the opportunity of arranging his affairs to the best possible advantage in the same way he would have been able to had he been receiving gross income, particularly in jurisdictions with opportunities for tax avoidance.

3.2.6 Movement to other jurisdictions and foreign tax law

Substantial differences exist between the tax laws of different jurisdictions, and combined with the increasing mobility of people, the possibility of injustice through the application of the Gourley rule becomes a real possibility. Thus to deduct from an award of damages an amount based upon the existing tax rates in the jurisdiction in which the plaintiff lived at the time of the injury might well create hardship for a person who might reasonably have anticipated, in the future, a transfer of his employment to another jurisdiction in which the rate of taxation is less.

Apart from this, a problem arises where part of the lost future

earnings would/....

earnings would have been earned abroad. Evidence of the foreign tax position would have to be adduced.

3.2.7 Encouraging unlawful acts

Limited primarily to awards for unfair dismissal, an employer might be tempted to dismiss an unwanted employee with the prospect of only paying damages based on the net salary rather than continue to employ him.

3.2.8 Practical difficulties in litigation

On whom does the onus rest to establish that Gourley applies? More importantly, who has to provide the court with the necessary material to make the tax calculation? It has also been suggested[14] that the Gourley principle may result in a significant intrusion into the privacy of the plaintiff, in relation to his financial affairs.

4. AUSTRALIA

4.1 Authorities prior to Gourley

According to Luntz[1] the earliest reference to the problem is in the sketchy report of Atkinson v Port Line Ltd[2] where Owen J ruled that "a jury in

assessing loss of earnings must calculate from net wages after tax was taken out and not from gross wages." In doing so, he declined to follow the then recent decision of Jordan v Limmer & Trinidad Lake Asphalt Co Ltd[3]. Jordan's case and the earlier English decision in Fairholme v Firth & Brown Ltd[4] were, however, relied on in Davies v Adelaide Chemical & Fertilizer Co (No. 2)[5], in which it was held that income tax was a matter between the taxation authorities and the plaintiff and of no concern to the defendant. As English, Canadian and New Zealand authorities in favour of making no deduction multiplied, the court in Lincoln v Gravil[6] was able to refer to the "settled practice which, it has been considered, ought not to be disturbed" of ignoring income tax in personal injury actions.

4.2 Gourley's case applied in Australia

Gourley's case changed the practice, with Australian State Courts regarding themselves as being bound by the decision, though there was for a time uncertainty as to whether in Australia it should be applied to past loss as well as future loss. The view which ultimately prevailed is that damages for personal injury are not taxable at all, whether relating to past or future loss, and therefore the conditions for the application of the Gourley principle are present in Australia.

One of the reasons why it has been held that damages for personal injury are not taxable (another being the interpretation of the Income Tax

Assessment Act 1936 (cth) has been the view that such damages are awarded for loss of earning capacity, a capital asset, and as such are not an indemnity in respect of income which would have been assessable. Luntz[8] feels this is an artificial distinction and favours the approach of Menzies J in FCT v Hatchett[9] where he said: "In the field of taxation, as in the field of business, 'capital' is used in contrast with 'revenue'; it has no reference to a man's body, mind or capacity."

Another reason for holding damages are not taxable is the (now less common) practice of awarding lump sums and the concomitant difficulty of extricating the amount awarded to loss of earning capacity. This difficulty, however, remains in the case of jury verdicts and especially in cases which are settled, the latter creating opportunities for tax evasion by allocating the major proportion of the award to other heads.

Once the courts had rejected the view that damages for past loss of earnings are taxable, Australian courts applied Gourley until 1978 almost without question, when the decision in Atlas Tiles v Briers[10] resulted in confusion, reinstating the distinction between past and future loss. A full bench of seven convened to hear the appeal in Cullen v Trappell[11] confirmed the authority of Gourley's case with regard to both future and past loss.

The result of the aforegoing, together with legislative enactments, means

the law/....

the law in Australia is the same as has prevailed in England since Gourley.

Some writers and some members of the Law Reform Committees have advocated the legislative solution of making the damages taxable, with due allowance for receipt in one tax year of damages representing many years of lost income. Such solution ensures that no loss is suffered by revenue, the inevitable loser under either alternative open to the Courts. This solution was rejected by a majority of the English Law Reform Committee on the ground that it would go against the fundamental principle that capital is not taxed, an objection which has lost some force since the introduction of capital gains tax in that Country.

5. CANADA

The Gourley decision was followed in some Canadian Courts[1], but when in 1966 it came to be considered by the Supreme Court in Canada in R v Jennings[2] it was unanimously repudiated, partially on evidential grounds, but also on grounds of substance. In the leading judgment, Judson J. expressed agreement with the dissenting views of Lord Keith in Gourley and quoted with approval the minority views of the English Law Reform Committee.[3]

In the case of Andrews v Grand & Toy Alberta Ltd[4], Dickson J summarised the position as follows:

"In the/....

"In the Queen v Jennings, this court held that an award for prospective income should be calculated with no deduction for tax which might have been attracted had it been earned over the working life of the plaintiff. This results from the fact that it is earning capacity and not lost earnings which is the subject of compensation. For the same reason, no consideration should be taken of the amount by which the income from the award will be reduced by payment of taxes on the interest, dividends, or capital gain. A capital sum is appropriate to replace the capital asset of earning capacity. Tax on income is irrelevant either to decrease the sum for taxes the victim would have paid on income from his job, or to increase it for taxes he will now have to pay on income from the award."

5.1 The Jennings Rationale

Six broad reasons for the decision are formulated by the learned authors of "Personal Injury Damages in Canada"[5]:

5.1.1 Under-compensation

Judson J. argued that tax should be ignored because personal injury plaintiffs are usually under-compensated, since the judiciary tends to be conservative in their estimate of average potential earnings; the normal reduction for contingencies is excessive and discount

rates are/....

rates are too high. Critics argue that an arbitrary inflation of damages through the medium of ignoring taxation is unjustified.

5.1.2 Inequity

The argument raised by Lord Keith of resultant inequity between comparable cases. This argument is criticised as misdirected reasoning inasmuch as the external circumstances of the plaintiff - such as independent income - are under consideration not because they show that the plaintiff will not need the damages, but because they would have affected the real value of his prospective earnings. It is argued that in terms of real value the inequity arises if tax is not taken into account since take-home pay more accurately reflects the plaintiff's personal financial loss.

5.1.3 Defendant Profitability

The argument averred to above (para 3.2.7) which applies in cases of wrongful dismissal.

5.1.4 Earning Capacity

"Damages . . . . should represent compensation for loss of earning capacity and not for loss of earnings. In a case of personal injuries, what the plaintiff has lost is the whole or part, as the case

may be, of his natural capital equipment and to tax him on this is contrary to generally accepted principles of taxation."[6] This view was quoted with approval by Judson in Jennings[7].

Cooper-Stephenson[8] describes this as a matter of terminology, not substance, and prefers to emphasise the underlying theoretical premise of the award. The author argues that the focus of assessment is an estimation of what the plaintiff could have earned but for his injuries.

5.1.5 Difficulty of Assessment

Whatever logic and policy dictate, so the argument goes, the increased difficulty in assessing damages, is an overriding consideration; there would be such a degree of uncertainty, that it would be best to leave the matter of taxation out of the award. Such difficulties are compounded in Canada, where each province has the power to impose taxation upon income, combined with the increasing movement of people from one province to another.

However, do the additional technical and procedural difficulties introduced by issues of tax require that, cumulative with the existing problems, the matter be left out of account? Should theory give way to practicalities?

5.1.6 Taxation of/....

5.1.6 Taxation of Damages

> "Consequently, the fact that the plaintiff would have been subject to tax on future income, had he been able to earn it, and that he is not required to pay tax upon the award of damages for his loss of capacity to earn income does not mean that he is over-compensated if the award is not reduced by an amount equivalent to the tax. It merely reflects the fact that the state has not elected to demand payment of tax upon that kind of receipt of money. It is not open to the defendant to complain about this consequence of tax policy and the Courts should not transfer this benefit to the defendant or his insurance company."[9]

A solution proposed is legislative reform resulting in the taxation of such awards. This is, however, criticised on grounds of loss distribution: by increasing the size of awards, the defendant and third-party loss spreading agencies are burdened with paying the tax the plaintiff would have paid, whilst the Gourley decision effectively burdens society as a

whole with/....

whole with the loss.

6. **UNITED STATE OF AMERICA**

Section 104(a)(2) of the Internal Revenue Code of 1954 excludes from gross income "the amount of any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injuries or sickness.", and it has been assumed that recoveries for loss of earnings are included in this exemption.[1] Thus the first requirement of the Gourley principle is satisfied.

Nevertheless, most courts compute loss of earnings without regard to the tax savings relying on the collateral source rule, the conjectural nature of tax estimates, the inability of juries to make the required computations and the complications which would otherwise be introduced to trials, and the congressional intent to give injured parties a tax benefit.[2] However, certain courts, for instance in Connecticut and Oklahoma, have followed the decision in Gourley.[3]

7. **ISRAEL**

The accepted view is that compensation for loss of earnings is capital, not revenue.[1] And in terms of the Income Tax Ordinance

1947, art 9(7), any capital sum received as general damages for death or physical injuries is not assessable to tax in the hands of the plaintiff. Gourley could, therefore, apply.

Moreover, the Civil Wrongs Ordinance which came into force in Palestine shortly before the termination of the Mandate in 1948 in effect introduced most of the English law of torts into the country. The ordinance is still part of the law in Israel and the Supreme Court of Israel, when ascertaining the law of its own country, almost always looks at the English cases in the law of torts. The English case of Billingham v Hughes[2] was followed in 1952 in Grossman v Roth[3] in deciding that tax ought not to be taken into account when assessing damages for loss of earnings. When Gourley overruled Billingham v Hughes, the Supreme Court was asked in 1957 in Kochevy v Baker[4] to likewise overrule its earlier decision. Judicial independence and national pride allowed the court to ask "In a case in which the Supreme Court of Israel gave a ruling and thereafter an English Court - and be it even the highest in that country - gives another ruling, are we entitled, or even bound to deviate from the Israeli precedent and to prefer the newer English precedent?"[5] The court held that the English precedent was no longer binding but was merely persuasive. In addition, on the merits, the court felt the rule which existed before Gourley was the desirable one.

In the/....

In the case of Khalif v State of Israel[6], Barak J remarked that "this matter goes beyond the realm of assessment of damage in tort, and is a legislative consideration which the law-maker ought to take into account."

Interestingly, Gourley is in effect applied in cases of injuries arising out of motor vehicle accidents and defective products. Section 4(a)(2) of the Road Accident Victims (Compensation) Law, 1975, provides: "Where the said compensation is exempt from income tax, the losses of the victim shall, for the purposes of that compensation, be calculated in accordance with his income after deduction of income tax due thereon at the time the compensation was fixed; provided that the reduction of the income through the deduction of tax as aforesaid shall not exceed 25 per centum of the income in accordance with which the compensation is calculated." Sec. 5(a) of the Defective Products (Liability) Law, 1980, is identical in content.

Aharon Yaron[7] argues that tax exemption for personal compensation should be abolished, and that gross compensation be awarded, but subject to income tax, thus resulting in the injured party receiving full compensation, the wrongdoer paying the full amount of damages, and the public not financing the wrongdoer.

8. SOUTH AFRICA/....

8. SOUTH AFRICA

When a plaintiff, who has suffered a remunerative loss at the hands of a defendant (whether as a result of a delict or breach of contract) and who receives a lump-sum award for loss of earning capacity, such damages awarded are considered to be of a capital nature and are accordingly not subject to income tax.[1]

Thus, in Pitt v Economic Insurance Co Ltd[2], Holmes J took into account tax in assessing damages. Whilst not attempting a precise calculation of the plaintiff's prospective tax liability, but bearing it in mind, Holmes J. also considered "the incidence of taxation in relation to interest obtainable on the court's award"[3] and "The possibility of avoiding it, at least in part, by recourse to tax-free investments."[4]

Although not dealing with loss of earnings, but for loss of proceeds of a crop of pineapples, Steyn JA, a month earlier, in Whitfield v Phillips[5] had expressed concerns with the desirability of following the Gourley doctrine. The court, inasmuch as it held that the onus was on the defendant to prove that the damages to be awarded to the plaintiff would not be subject to tax, and the defendant failed to do so, found it unnecessary decisively to determine the relevance of tax. The learned judge of appeal considered that the question as to

whether or not the award would be subject to taxation was to be entrusted solely to, in the first instance, the Commissioner for Inland Revenue, and, thereafter on appeal, to the Special Court for hearing income tax appeals. As is pointed out by Gauntlett in "The Quantum of Damages"[6], the situation in this regard has changed.

Henochsberg J. rejected Steyn's argument in Gillbanks v Sigourney[7] and held that whether an award of damages constitutes untaxable capital or taxable income is a question of law that any court is competent to determine. Henochsberg J went on to hold that in principle, the Gourley doctrine was correct and agreed with Holmes J. - in Pitt, and allowed the plaintiff's prospective tax liability (despite paucity of evidence) by treating it as one of the contingencies calling for a deduction from gross damages. Regrettably, Schreiner JA. in the appeal hearing[8] was obliged to decline to decide how tax should be treated without full argument on the difficult questions involved. The learned judge of appeal was, however, moved to note that the procedure was "hardly . . . . logically satisfying."[9] The paucity of the evidence meant that Schreiner JA. held that the tax factor should be disregarded in deciding the appeal.

In Snyders v Groenewald[10], a dependant's action, Van Winsen J. based his award of damages for loss of support on the deceased

breadwinner's anticipated future income after tax since ignoring tax "would mean assuming a higher net income than would in fact have accrued to the deceased had he lived. The widow and children would thereby be placed in a more favourable position than had the deceased been alive today."[11] Unfortunately, on appeal[12], the tax issue was not even raised.

In Oberholzer v Santam Insurance Co Ltd[13], Fannin J. agreed that tax had to be taken into account in assessing damages for loss of earnings. In Omega Africa Plastics (Pty) Ltd v Swisstool Manufacturing Co (Pty) Ltd[14], the Appellate Division declined to deduct tax inasmuch as it considered the damages (for infringement of a registered design) would probably be taxable as income in the plaintiff's hands.

Boberg[15] gains the impression from a passing remark in Van der Plaats v S A Mutual Fire and General Insurance Co Ltd[16] that actuaries make a practice of deducting tax from estimates of future earnings and that this is generally accepted by the trial courts and the issue is not raised on appeal.

An anomaly which has arisen is that where damages are paid by way of instalments in terms of South Africa's third party motor vehicle insurance, such instalments are subject to taxation.[17] And whilst the

cases to/....

cases to date have dealt with provisions contained in the previous acts, Dendy[18] notes that the Road Accident Fund Bill published on 26 May 1995, and which will eventually replace the 1989 Act, provides in clause 17(4)(b) for the payment of compensation for future loss of income or support "by instalments in arrear as agreed upon or as directed by a court", and thus the problem is likely to occur more often. As Boberg notes,[19] this means that a plaintiff who is compensated in instalments, could be worse off (because tax is taken into account) than one who receives a lump-sum award, since as is illustrated by the case of Marine & Trade Insurance Co Ltd v Katz No. 1979(4) SA 961(A), the tax payable on each instalment does not necessarily equal the tax which would have been payable on the lost income.

Whilst the question as to whether or not the Gourley principle should be adopted has not been definitively decided by the Appellate Division, it would appear that the preponderance of academic opinion favours the Gourley approach, some regarding it as a contingency.[20] Although McKerron[21] initially stated "there can be little doubt that it is in principle correct", the emphasis of his view shifted when he pointed out that "the invocation of the doctrine can convert a comparatively straightforward claim for damages for loss of income into an intricate and protracted dispute concerning the plaintiff's tax position . . . . litigation is hazardous enough as it is,

and it/....

and it is clearly undesirable that it should be made more so. Considerations of logic and elegantia juris must sometimes give way to considerations of expediency and convenience. . . . This is a matter in which the latter should prevail."[22] Gauntlett[23] sees as a distinction of degree rather than kind the difficulties attendant upon allowing for the incidence of tax and provision for other factors in the assessment of damages.

Van Heerden[24] strongly opposes the deduction of tax, for reasons similar to those adduced by writers such as Dworkin and referred to above (paragraph 3.2) and he is supported in his view by the learned authors of Law of Damages[25] who remark:

> "It is for the state to decide whether it wants to tax someone whose income has been replaced by a capital amount. It is unacceptable to allow a wrongdoer to benefit at the expense of an aggrieved person as well as the state."

A M Honore[26] rejects Gourley on principle because "when a plaintiff obtains a tax free award . . . . he does not profit from the injury which is the occasion of the award. He profits from the state of the law of taxation, which treats the award as capital, and the remedy for this, if it is unjust, is to amend the tax law in order to make the award taxable as if it were

income earned/....

income earned over a period." C F C Van der Walt[27] accepts the principle but believes it deprives the plaintiff of a tax benefit which the State intended him to have.

9. **"A ROSE BY ANY OTHER NAME. . . ."**

Street observes: "Close scrutiny of the Lloyd's List Law Reports, which report those parts of judgments dealing with damages more fully than any other series, reveals that the courts use the expressions 'loss of earnings' and 'loss of earning capacity' quite indiscriminately, as if nothing would depend on their choice."[1]

Our courts are no less guilty. In Commercial Union Assurance Co of S A Ltd v Stanley[2] the learned judge of appeal, Wessels J A, pointed out (at 705A) that the plaintiff's claim for loss of future earnings was "in effect" a claim for "the dimunition in her case of her earning capacity which, but for the collision, could have been commercially exploited in various fields of employment." It would appear that Wessels regards them as "in effect" the same thing. In the case of Hogan, Joubert ALJ refers to the loss in question there as a "toekomstige verlies aan inkomste" (at 158G-J) or a "Toekomstige verlies van inkomste" (at 159H-J) instead of a "toekomstige verlies aan verdienvermoe", which he appeared (at 155B-C, 159B) to regard as an equivalent concept. No less our acadamics, for example, Emslie et al[3] where the authors label the damages as being for "loss of

future earnings"/....

future earnings" whereas Dendy[4] maintains that inasmuch as a long line of Appellate Division decisions have held that damages are awarded for loss of earning capacity, there is no longer such a thing as loss of future earnings.

In Canada, according to Cooper-Stephenson[5], the judiciary have described this head of damages as "loss of earnings", "loss of ability to earn", "loss of earning capacity", "loss of time", "loss of prospective earnings", "loss of working capacity" and "loss of the value of prospective work".

Does anything turn on what term is used? Boberg's answer to this question is an emphatic yes.[6] He maintains the concepts differ both from a theoretical and a practical point of view: Compensation for loss of future earnings depends upon proof of what the plaintiff would, as a matter of probability, actually have earned in the future had he not been injured. Compensation for loss of earning capacity, on the other hand, requires no such proof. It does not signify whether he would actually have earned the money or not: it is for his loss of his capacity to earn - irrespective of how he would have utilised it - that he is being compensated.

To illustrate this view, Boberg[7] cites a case quoted by Street in Principles of the Law of Damages of The Susquehanna[8] where an obiter dictum of Merrivale P favours the loss of earnings approach:

"In an/....

> "In an ordinary common law action for damages a highly skilled medical missionary wrongfully detained from his benevolent activities might be awarded damages on a different scale from those which would result from the wrongful detention from work of a professional man of like abilities engaged in a lucrative practice."

A similar view was adopted in an Australian Case, Wege v Elphick[9], where it was held that the plaintiff, a highly skilled engineer who preferred to pursue his less remunerative hobby of watch repairing, rather than his profession, was entitled to damages on the basis of his actual, not potential earnings.

In the United States, according to Street, damages are for loss of earning capacity, not earnings, so that damages of this kind are recoverable.

An obiter dictum of Diplock L J in Browning v War Office[10] indicates the law in England adopts a loss of earnings approach, where it is said at page 766:

> "A plaintiff is not entitled to damages for loss of capacity to earn money unless it is established that he would, but for his injuries, have exercised that capacity in order to earn money."

The authors/....

The authors Kemp[11] agree with this dictum, subject to the qualification that "account should be taken of the possibility of loss of future earnings even where at the time of the trial such loss cannot be established as a certainty. For example, a married woman who had given up a career as a doctor to look after her young children, before she suffered the injuries complained of, who had had no plans to resume that career, ought to receive some compensation for her inability to resume that career, if there was a possibility that in changed circumstances she might have wished to do so."

In Santam Versekeringsmaatskappy Bpk v Byleveldt[12], which dealt with whether damages can be recovered for a loss of wages which has, in fact, not been sustained because it has been made good by the employer, the AD held (by a majority of four to one) that the plaintiff was entitled to recover the "lost" wages. Rumpff JA said (at 150C-D):

> "Die verlies van geskiktheid om inkomste te verdien, hoewel gewoonlik gemeet aan die standaard van verwagte inkomste, is 'n verlies van geskiktheid en nie 'n verlies van inkomste nie."

Trollip JA, dissenting, found that the wages could not be recovered because the plaintiff was paid the post-accident wages as a right for services rendered under an enforceable contract of employment. Referring to an American case in which post-accident wages similar to those in the present case had

been disregarded by the court because such damages were for "impairment of capacity to labour and not for wages as such", Trollip stated (at174):

> "But that is not the approach in our law. Basically, it is true, the compensation our courts award is also for impairment of the capacity to earn, but generally it is measured by reference to the loss of earnings. Where the injured party was in normal employment at the time he was injured and would have continued in it but for his incapacitation, such employment is ordinarily regarded as reflecting his earning capacity. His loss of earnings, actual or prospective, is, therefore, usually taken as the true measure of the impairment of his earning capacity."

Krishna[13] believes that the "verbal misuse of (the) phrases" results in part from a lack of appreciation of the underlying theoretical premise, and divides the two schools of thought into the "capital asset" school, which suggests that a personal injury damage award is a replacement of lost earning capacity, and which favours non-taxation of any portion of the damages award recovered; and the "substitution" school, which views compensation so received as a replacement of loss of earnings and which favours "taxation" of the award, either "theoretically" as in the case of Gourley, or actually, on receipt of the award. In Canada, the view of the "capital asset" school prevails by virtue of the Supreme Court decision in Jennings.

Accordingly to/....

Accordingly to Luntz[14] since the publication of an "Excursus" on the topic by Professor Ross Parsons in (1955) 28 ALJ 563, 571 - 572, the High Court of Australia, in its language at least, has favoured the concept of damages being awarded for an immediate dimunition in the capacity to earn, rather than for loss of earnings as such. Professor P.S. Atiyah[15] feels that such a conceptual approach should not be allowed to govern the outcome in any particular situation. Instead, a functional approach should be adopted in terms whereof each situation is evaluated independently, so that it may be more properly said in some instances that loss of capacity is the relevant criterion while in others that loss of earnings must be established. This, it is submitted, would resolve the problems referred to by Boberg.

Cooper-Stephenson[16] avers that the appropriate terminology is not important but that an issue of substance underlies the terminology - whether damages should be assessed on the basis of what the plaintiff as a matter of prediction would have earned in fact, or, on the other hand, whether the assessment should be based on what the plaintiff had the capacity to earn, irrespective of whether he would in fact have exercised that capacity. The learned author does not support one or other view, but prefers as a basis for computation "loss of the value of prospective work." : that, though "loss of prospective earnings" will normally be the correct means of valuing prospective work, in some cases it is appropriate to look beyond the direct remuneration which would have been received, and to value the loss by other means. In this manner, the courts would be able to inject notions of

the quality/....

the quality of what has been lost, rather than having to reflect merely its direct financial cost.

10 PRINCIPLE V PRACTICE AND POLICY

The problem of the tax factor in damages has been described as one which superficially appears to present a clash between logic and sound principle on the one hand and the desire for simplicity on the other[1]. Gourley proponents argue it is sound both in practice and in principle: Tax ought to be taken into consideration. Critics maintain that even if the principle is correct, this is one occasion when theory ought to give way to expediency: ignore the tax factor and no problem exists.

Neither approach is theoretically valid. Before Gourley, the law was over-generous to the plaintiff and unfair to the defendant, who paid more than the compensatory damages, and unfair to Revenue, which is deprived of tax from the plaintiff as a result of the defendant's act. Since Gourley, the position may still be unfair to the plaintiff (since only estimations of future tax rates can be made) and Revenue still loses out.

Dworkin's[2] suggestion, and he has many supporters[3], is that all damages which are awarded for loss of taxable income or capital should be taxed and various models as to how the tax loan should be spread are proposed. This, of course, goes against the long-held view in many jurisdictions that capital

should not/....

should not be taxed.

There are, of course, other views as to the purpose of delictual awards. The aforegoing is based upon the so-called dominant rule - that of compensation - that the plaintiff should not be placed in a better position than he would have been had the delict not occurred. It has already been noted that because of the concept of collateral benefits, this rule is already somewhat artificial. Remedies in delict also serve a function in loss distribution and in discouraging wrongful conduct.

11 CONCLUSION

Silke[1] states "an amount received by way of damages or compensation for loss, surrender or sterilisation of a fixed capital asset or of a taxpayer's income producing machine is a receipt of a capital nature" and thus is not subject to income tax. He goes on to state[2] "where the damages or compensation are paid to compensate a taxpayer for loss of profits that he might otherwise have earned. . . . they are of an income nature.". The learned authors, Meyerowitz & Spiro[3] state at paragraph 423, under the heading "Delict" : "If the damages are to take the place of the earnings which the taxpayer would have had without the injury etc. there is ex hypothesi no reason why the taxpayer should not be liable in tax thereon." Dendy[4] maintains that where a lumpsum award for loss of earning capacity is made, the damages awarded are of a capital nature, and not subject to tax.

We know,/....

We know, however, that where the award takes the form of an annuity, it is subject to tax.[5]

With respect, therefore, it is not entirely clear whether the first criterion for Gourley to apply (i.e. the award must not be subject to taxation) is met in South Africa. This difficulty is one of the objections raised by nearly every critic of the rule in Gourley. Moreover, as already indicated, Revenue would not be bound by the court's decision in this regard, raising the possibility of under-compensation of the plaintiff who is taxed on an award already reduced to reflect lost "net earnings."

Many authors propose payment of such awards by instalments arguing that this does away with a court having to "ponder the imponderable" and will allow for the plaintiff to receive an award which more accurately reflects the actual loss suffered by him. With respect, such a proposal will require the creation of structures to administer and continually re-evaluate awards. In addition, whilst perhaps feasible where the financial ability of the defendant to continue to pay instalments over a lengthy period is beyond question (something which may become increasingly rare), it is submitted that such an approach really does not eradicate the difficulty of deciding how much capital should be set aside or secured. The plaintiff, it is submitted, would also have his mobility reduced - would, for instance, he be entitled to move to a jurisdiction with higher tax rates but greater social benefits?

Applying Gourley also creates difficulties in attempts to settle claims, for instance by means of payments into court. A defendant would be faced with an additional problem of determining a plaintiff's prospective tax liability.

Plaintiffs will also be faced with a further financial hurdle in having to consult and retain experts to determine prospective tax liability. It is submitted that inasmuch as defendants are often insurers or state institutions with vast resources, plaintiffs will be prejudiced further.

Inasmuch as it is submitted that it is all but impossible to achieve a result which is logically satisfying in every respect, considerations of policy should prevail. If Gourley is applied, revenue is lost and society as a whole subsidises the wrongdoer. South African courts, it is submitted, are extremely conservative and a plaintiff in a personal injury action is more likely to be under-compensated than over-compensated. I accordingly would prefer the tax saving to accrue to the plaintiff rather than the defendant and must agree with Lord Keith in Gourley and Judson J. in Jennings when they advise the pro-fiscus lobby to seek redress of any perceived imbalance through legislation, rather than the application of the rule in Gourley.

FOOTNOTES

2. **INTRODUCTION**

1. H Luntz: "Assessment of Damages for Personal Injury & Death" p263.
2. Ibid p264.
3. PQR Boberg: "The Law of Delict" p544.
4. 1993 (4) SA 150 (A).
5. Act 56 of 1972.
6. See for instance: Kathleen van der Linde: "Damages for Loss of Future Earnings - the implications of a certificate issued in terms of S43(b) of the MMF Act: KBI v Hogan" (1994) 57 THRHR 338; K van der Linde: "Damages for loss of future earnings" (1994) 2 Juta's Business Law 37; M. Dendy "Damages for Loss of Earning Capacity - the Income Tax Ramifications I : Compensation by Annuity," 112 (1995) SALJ 643.
7. Per Trollip JA in Marine & Trade Insurance Co v Katz No. 1979 (4) SA 961(A) at 973.
8. PQR Boberg "Should damages be reduced by future tax payable?" (1981) 11 Businessman's Law 25 at 26.

3. RULE IN GOURLEY'S CASE

1. [1956] A.C. 185 (HL).
2. H. McGregor: "McGregor on Damages". p299 and the authorities there cited.
3. [1949] 1 K.B. 643.
4. At pp 202, 203.
5. See first paragraph of headnote at p185.
6. p197.
7. McGregor p299.
8. p218.
9. Damages and Tax - A Comparative Survey.
10. Ibid p320.
11. Ibid p321.
12. Page 204.
13. For example, Street "Principles of the Law of Damages." p102.
14. Bale: "BTC v Gourley Reconsidered" at p96.

4. AUSTRALIA

1. Assessment of Damages p264.
2. NSW SC, Sydney Morning Herald, 20/6/46.
3. [1946] KB 356.
4. (1933) 149 LT 332.

5. [1947] SASR 67.
6. (1954) 94 CLR 430 at 442.
7. Luntz p265 and the authorities cited there.
8. Ibid.
9. (1971) 125 CLR 494 at 497.
10. (1978) 21 ALR 129.
11. (1980) 29 ALR 1.

5. CANADA

1. Cooper-Stephenson & Saunders "Personal Injury Damages in Canada" p183 and the cases there cited.
2. (1966), 57 D.L.R. (2d) 644 (SCC).
3. Law Reform Committee, Seventh Report, Cmnd. 501.
4. (1978), 83 D.L.R. (3d) 452 (SCC) at 474 - 475.
5. Op cit p185.
6. Law Reform Committee, Seventh Report, Cmnd. 501. p4.
7. At page 655
8. Op cit p188.
9. Per Judson J at 656.

6. UNITED STATES OF AMERICA

1. Harvard LR V69 part 2 p1496.

2. "Unreason in the Law of Damages: The Collateral Source Rule." Harvard LR Vol 77, Part 1., p747.
3. Ibid.

7. ISRAEL

1. Dworkin: "Damages and Tax : A comparative Survey" p379.
2. [1949] KB 643.
3. C.A. 70/52, 6 Piskei Din 1242.
4. C.A. 81/55, 11 Piskei Din 225.
5. Ibid at p235.
6. (1981) 35 (ii) P.D. 242 at 251.
7. "Tax Aspects in Tort Compensation" 22 Isr. L. Rev. 37 (1987).

8. SOUTH AFRICA

1. Mervyn Dendy: "Damages for loss of earning capacity - The Income Tax Ramifications I : Compensation by Annuity." (1995) 112 SALJ 643 at p643 f n 2.
2. 1957 (3) SA 284 (D).
3. Ibid at 287.
4. Ibid at 289.
5. 1957 (3) SA 318 (A).
6. Page 69 fn 244.

7. 1959 (2) SA 11 (N).
8. Sigournay v Gillbanks 1960(2) SA 552(A).
9. Ibid p568.
10. 1966 (3) SA 785(C).
11. Ibid p789.
12. Groenewald v Snyders 1966 (3) SA 237 (A).
13. 1970 (1) SA 337 (N).
14. 1978 (3) SA 465 (A).
15. The Law of Delict p544.
16. 1980 (3) SA 105 (A) at 114D.
17. Marine & Trade Insurance Co Ltd v Katz No. 1979 (4) SA 961(A); Kommissaris van Binnelandse Inkomste en 'n Ander v Hogan 1993 (4) SA 150 (A).
18. Op cit at 645.
19. Op Cit p545.
20. Boberg p545 and the authors there referred to.
21. (1956) 73 SALJ 203 at 205.
22. (1957) 74 SALJ 367 at 368.
23. The Quantum of Damages p70.
24. JC Noster 9.
25. Visser & Potgieter at p203.
26. (1959) 76 SALJ 341 at 342.
27. (1980) 43 THRHR 1.

9. **"A ROSE BY ANY OTHER NAME . . . ."**

1. H Street "Principles of the Law of Damages" p47.
2. 1973 (1) SA 699 (A).
3. T S Emslie, D M Davis & S J Hutton : "Income Tax Cases & Materials" p617.
4. Op cit p650.
5. Op cit p196.
6. Annual Survey of South African Law 1973 p180.
7. Ibid p182.
8. [1925] p196 (CA).
9. (1947) 49 WALR 83.
10. [1963] 1 QB 750 (CA).
11. The Quantum of Damages Law & Practice Special Edition 1986 Sweet & Maxwell p6008.
12. 1973 (2) SA 146 (AD).
13. Vern Krishna: "Taxation of Personal Injury Awards: A Wiry Methuselah" 1976-77, 3 Dalhousie LJ 385 at p398.
14. Assessment of Damages for Personal Injury & Death p227.
15. "Loss of Earnings or Earning Capacity?" (1971) 45 ALJ 228.
16. Op cit p196.

10 PRINCIPLE V PRACTICE & POLICY

1. G Dworkin: Damages & Tax - A Comparative Survey at p326.
2. Ibid 327.
3. See for instance: Bishop & Kay: "Taxation of Damages" 104 LQ Rev. 211 (1987) and Yoran "Tax Aspects in Tort Compensation" 22 Isr. L. Rev. 37 (1987).

11. CONCLUSION

1. South African Income Tax. p81.
2. Ibid.
3. Meyerowitz & Spiro on Income Tax.
4. Op cit p643.
5. Hogan's case.

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