

**Assessed losses:**

*A critical analysis as to whether a company is entitled to carry forward assessed losses if such company has traded but has derived no income therefrom*

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*"Render therefore to Caesar the things that are Caesar's, and to God the things that are God's."*

Jesus Christ. Matthew 22:21, The New King James Version.

## **Abstract**

The Income Tax Act No 58 of 1962 provides for tax to be levied on an annual basis (i.e. income and expenditure are generally calculated and determined in respect of a single year of assessment). Section 20(1) makes provision for the possibility that the allowable deductions may exceed a taxpayer's income by allowing for the carrying forward of any balance of assessed loss to subsequent years of assessment. It therefore provides for taxpayers to utilise assessed losses determined in previous tax periods against the income derived in future tax periods.

Our courts have decided that a company which does not trade during a specific year of assessment forfeits its right to carry forward its balance of assessed loss from the preceding year of assessment. What has been left undecided in our superior courts however (although has been considered in our Tax Courts), is whether a company would also forfeit its right to carry forward its balance of assessed loss in the event where such a company carried on a trade during the current year of assessment, but derived no income therefrom.

The primary research question in this study is whether a company would be allowed to carry forward its balance of assessed loss determined at the end of its previous year of assessment to its current year of assessment, in circumstances where it derived no 'income' from its trading activities during the current year of assessment. This study also considers, as a secondary research question, whether the recent proposals made by Treasury in terms of the Budget Speech held on 26 February 2020, would have an impact on the primary research question.

In order to address the primary and secondary research questions, this study considers the wording of section 20 in the light of the guidance on interpreting fiscal statutes as provided by our courts. The study also considers the views expressed in our courts in relation to section 20(1) as well as the relevant commentary on these views. Furthermore, the study considers SARS' view on section 20 as well as whether the recent proposals made by Treasury have an impact on the carrying forward of a company's balance of assessed loss.

It is concluded that in terms of the recent proposal made by Treasury, a company whose trading activities result in a loss should be unaffected by the proposed amendments, although this can only be confirmed once the proposed legislation in this regard has been made available.

It is further concluded that a superior court has not yet interpreted section 20(1) in terms of the current approach to the interpretation of statutes, and it is submitted that a superior court may come to the conclusion that a company would be allowed to carry forward its balance of assessed loss determined at the end of its previous year of assessment to its current year of assessment, even though it had derived no income from its trading activities during its current year of assessment.

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## CHAPTER 1: INTRODUCTION

### 1.1 Background

The Income Tax Act No 58 of 1962 ("the Act")<sup>1</sup> provides for tax to be levied on an annual basis (i.e. income and expenditure are generally calculated and determined in respect of a single year of assessment).<sup>2</sup> This creates an artificial result as a taxpayer's trading activities are often not wholly reflected in a single annual period.<sup>3</sup>

Section 20(1) makes provision for the possibility that the allowable deductions may exceed a taxpayer's income by allowing for the carrying forward of any balance of assessed loss to subsequent years of assessment.<sup>4</sup> It therefore provides for taxpayers to utilise assessed losses<sup>5</sup> made in previous tax periods against the income derived in future tax periods.<sup>6</sup>

Our courts have decided that a company which does not trade during a specific year of assessment forfeits its right to carry forward its balance of assessed loss from the preceding year of assessment (hereafter referred to as the "trade" requirement).

What has been left undecided in our superior courts, although the matter has been considered in our Tax Courts,<sup>7</sup> is whether a company would also forfeit its right to carry forward its balance of assessed loss in the event where such a company carried on a trade during the current year of assessment, but derived no income therefrom (hereafter referred to as the "income" requirement).

By way of illustration, assume for example a company is engaged in farming activities and incurred deductible expenditure in the amount of R 1 million during its 2019 year of assessment, but only derived income in the amount of R 100,000 as a result of a drought. The aforementioned would result in an assessed loss to be determined in the amount of R 900,000 at the end of its 2019 year of assessment. During its 2020 year of assessment the effects of the drought were such that, even though the company incurred deductible expenditure in the amount of R 800,000 it was unable to derive any income from its farming operations.<sup>8</sup> The question that arises, therefore, is whether the company would be allowed to carry forward its balance of assessed loss determined at the end of its 2019 year of assessment (i.e. R 900,000) to its 2020 year of assessment even though it had derived no 'income' from its trading activities conducted during its 2020 year of assessment, or alternatively, whether it would forfeit its right to carry forward its balance of assessed loss determined at the end of its 2019 year of assessment as a result of no 'income' that was produced during its 2020 year of assessment.

Another similar example would be where a company that provides seasonal services had determined an assessed loss during its previous year of assessment, but was unable to produce any 'income' from its trading activities during its current year of assessment as a result of the

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<sup>1</sup> This study takes into account all relevant tax legislative amendments up to and including the amendments brought about by the Taxation Laws Amendment Act No 34 of 2019. All references to 'section' are to sections of the Act and references to 'paragraph' are to paragraphs of the Eighth Schedule to the Act, unless indicated otherwise.

<sup>2</sup> Definition of "gross income" read with the definition of "year of assessment" in section 1(1).

<sup>3</sup> Olivier, L. "Assessed Losses: A Note on the Trade and Income Requirements." Stellenbosch Law Review 13, no. 3 (2002): 387-393 at 387.

<sup>4</sup> Swart, GJ. "The Utilization of Assessed Losses by Companies - A Reappraisal After *Conshu (Pty) Ltd v Commissioner for Inland Revenue*." South African Mercantile Law Journal 8, no. 1 (1996): 119-144 at 127.

<sup>5</sup> Section 20(2) provides that an "assessed loss" means any amount by which the deductions admissible under section 11 exceeded the income in respect of which they are so admissible.

<sup>6</sup> Supra. fn. 4.

<sup>7</sup> *ITC 664* (1948) 16 SATC 125 (U), *ITC 1679* (1999) 62 SATC 294 (O), *ITC 1830* (2007) 70 SATC 123 (G).

<sup>8</sup> See similar example in: Swart, GJ. "The Requirements for the Utilisation of Assessed Losses by Companies - Rational Policy Or Muddled Thinking." South African Mercantile Law Journal 13, no. 1 (2001): 455-464 at 457.

restrictions imposed during the worldwide Covid-19 pandemic that started during 2020 (such as the national lockdown in South Africa and the closure of its borders).

The South African Revenue Service ("SARS") is of the view that section 20(1) contains both the 'trade' and 'income' requirement, but accepts that this may have some unintended consequences.<sup>9</sup> In dealing with these so-called unintended consequences, SARS concedes (although only in limited circumstances) that a company would be entitled to carry forward its balance of assessed loss from the preceding year as long as the taxpayer proved that it had carried on a trade during the current year of assessment (i.e. even though it derived no income from carrying on that trade).

Given the absence of a conclusive decision made by a superior court in this regard, and the concession provided by SARS (although only in limited circumstances) there is uncertainty as to whether a company would be allowed to carry forward its balance of assessed loss determined at the end of its previous year of assessment to its current year of assessment, even though it had derived no 'income' from its trading activities during its current year of assessment. This would be especially relevant to companies that actively traded during their current year of assessment, but as a result of the Covid-19 pandemic were unable to produce any 'income' during their current year of assessment.

## **1.2 Research question**

The primary research question in this study is whether a company would be allowed to carry forward its balance of assessed loss determined at the end of its previous year of assessment to its current year of assessment in circumstances where it derived no 'income' from its trading activities during the current year of assessment. This study also considers, as a secondary research question, whether the recent proposals made by Treasury in terms of the Budget Speech held on 26 February 2020, would have an impact on the primary research question.

In order to address the primary and secondary research questions, the wording of section 20, in the light of the court's guidance on interpreting fiscal statutes, is considered. The views expressed in our courts in relation to section 20(1) and the relevant commentary thereon, are also considered. Furthermore, note is taken of SARS' views on section 20(1) as expressed in Interpretation Note 33. Finally, the recent proposals made by Treasury and the impact thereof on the carrying forward of a company's balance of assessed loss are considered.

## **1.3 Methodology and Chapter Structure**

This study adopts a doctrinal methodology. This begins, in Chapter 2, with an analysis of the relevant wording of section 20 and thereafter the relevant sections of the Act that should be considered in determining whether a company would be allowed to carry forward its balance of assessed loss from its preceding year of assessment to its current year of assessment, in light of the relevant principles governing the interpretation of fiscal statutes.

Chapter 3 briefly discusses the circumstances in which SARS may provide a concession to taxpayer companies in respect of the carrying forward of their balance of assessed losses as well as the status of SARS' interpretation notes in interpreting legislation in our courts. Chapter 4

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<sup>9</sup> SARS Interpretation Note 33 (issue 5) 5 May 2017 at 5.

analyses the relevant views held in the South African courts in the context of section 20(1), considering only those cases that are most relevant for the purpose of the research questions in this study.

Chapter 5 applies the principles pertaining to the interpretation of statutes to the provisions of section 20(1). Chapter 6 considers whether the proposals made by Treasury in terms of the Budget Speech will have an impact on the primary research question in this study. Finally, Chapter 7 contains a summary of the conclusions drawn from the preceding chapters, and concludes on the primary and secondary research questions.

#### **1.4 Limitations to the study**

The focus of this study is on the provisions of section 20(1) in the context of a company, although reference to the application to persons other than companies will be made (as section 20(2A) provides for two concessions which are available to persons other than companies, which is discussed in more detail in later chapters).<sup>10</sup> The provision pertaining to the ring-fencing of assessed losses of certain trades (i.e. section 20A) is beyond the scope of this study, as section 20A applies specifically to a natural person and would therefore not apply to a company. This study contains a brief overview of the application of section 103(2), but will not contain a detailed analysis thereof (i.e. where a change in shareholding has been effected or an agreement has been entered into for the purpose of utilising an assessed loss).

Finally, the focus of this study is on companies that conduct a recognisable trade (i.e. the companies would comply with the 'trade' requirement). As a result of the aforementioned, it is accepted in this study that the 'trade' requirement would be met and that any pre-trade expenditure and losses are also not considered.

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<sup>10</sup> Refer to Chapter 2.2, Chapter 2.6, Chapter 4.3.2, Chapter 4.8, Chapter 4.11, Chapter 4.12, Chapter 5 and Chapter 7 for the discussions on section 20(2A).

## CHAPTER 2: RELEVANT PRINCIPLES TO CONSIDER

### 2.1 Introduction

Section 20(1) essentially deals with the carrying forward of a balance of assessed loss determined by a taxpayer during a previous year of assessment to the current year of assessment, which is then utilised against the income derived from the taxpayer's trading activities during its current year of assessment. There are, however, certain relevant principles and sections in the Act (such as the requirement to carry on a trade during its current year of assessment) which are considered in determining whether a company would be allowed to carry forward its balance of assessed loss. The purpose of this chapter is firstly to contextualise the research question by considering the relevant wording of section 20. This chapter also serves to highlight the relevant principles of interpretation to be applied when considering the research question. Finally, the chapter provides an overview of other sections in the Act that should be considered in analysing the research question. A number of the principles highlighted in this chapter are then analysed further in later chapters.

### 2.2 Relevant wording of section 20

The relevant wording of section 20 serves as the starting point of this study. The opening paragraph of section 20(1), reads as follows:<sup>11</sup>

*"For the purpose of determining the taxable income derived by any person from carrying on any trade, there shall, subject to section 20A, be set off against the income so derived by such person—*

*a) any balance of assessed loss incurred by that person in any previous year which has been carried forward from the preceding year of assessment..."*

Section 20(2), which defines an assessed loss, reads:

*"For the purposes of this section "assessed loss" means any amount by which the deductions admissible under section 11 exceeded the income in respect of which they are so admissible."*

Whereas, section 20(2A), which provides for a concession to any person other than a company, reads:

*"In the case of any person other than a company—*

*a) the provisions of subsections (1) and (2) shall mutatis mutandis apply for the purpose of determining the taxable income derived by such person otherwise than from carrying on any trade, the reference in subsection (1) to "taxable income derived by any person from carrying on any trade" and the reference in that subsection to "the income so derived" being respectively construed as including a reference to taxable income derived by that person otherwise than from carrying on any trade and a reference to income so derived; and*

*b) the said person shall, subject to the provisos to subsection (1), not be prevented from carrying forward a balance of assessed loss merely by reason of the fact that he has not derived any income during any year of assessment."*

The above-mentioned provisions contain the relevant terms which should be considered in determining whether a company would be allowed to carry forward its balance of assessed loss.

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<sup>11</sup> The proviso to section 20(1)(a) determines that no person whose estate has been sequestrated shall be entitled to carry forward any assessed loss incurred prior to the date of sequestration, unless the order of sequestration has been set aside.

Included in the above is the question of whether a company traded during the current year of assessment (i.e. the 'trade' requirement). Another consideration which requires clarity is what is meant by the term 'income' against which an assessed loss is 'set off'. Both of these terms are discussed in more detail in terms of the subsequent headings contained in Chapter 2.

The concession provided in terms of section 20(2A)(a) to persons other than companies, essentially means that persons other than companies are allowed to utilise their assessed losses against income derived other than from carrying on a trade (such as interest earned in a bank account). This concession therefore overrides the 'trade' requirement, which is still applicable to companies. In addition to the aforementioned concession, section 20(2A)(b) provides that such persons may carry forward their balance of assessed loss indefinitely until there is income against which it can be set off (although subject to the provisos of section 20(1)). Chapter 5 considers whether the latter concession can be construed to mean that a company which does not earn any income during a year of assessment forfeits its right to carry forward its balance of assessed loss.

### 2.3 The interpretation of statutes

The primary research question of this study addresses the interpretation of section 20(1) as to whether a company would be allowed to carry forward its balance of assessed loss determined at the end of its previous year of assessment to its current year of assessment, even though it had derived no 'income' from its trading activities during the current year of assessment. In addressing the primary research question it is required that the relevant principles to the interpretation of statutes be considered. These will eventually be applied in determining the answer to the primary research question of this study.

Using a literal interpretation of the wording of section 20(1) and by giving the wording its plain meaning as it stands, it would be difficult to conclude that a company would be allowed to carry forward its balance of assessed loss from the preceding year of assessment in the event where there is no income which is available to set off against the balance brought forward. Also, considering the semantic meaning of the word 'set off' (which is discussed in more detail in Chapter 4.2.2) one would find it difficult to interpret it to mean that a negative amount (i.e. a loss in the current year) is set off against another negative amount (i.e. the balance of assessed loss brought forward from the preceding year of assessment). Semantically, where two negative amounts are brought together with the result of a larger assessed loss, it would not be as a result of such amounts being set off against one another, but clearly as a result of such amounts being added to one another - which is, in fact, an addition.<sup>12</sup>

The approach of statutory interpretation in our courts has undergone various changes over the past number of decades.<sup>13</sup> The current approach to the interpretation of statutes was settled by the decision of the Supreme Court of Appeal in *Natal Joint Municipal Pension Fund v Endumeni Municipality*.<sup>14</sup> During this judgement, Wallis JA<sup>15</sup> stated the following principles, which should be adhered to in interpreting any document:

*"Interpretation is the process of attributing meaning to the words used in a document, be it legislation, some other statutory instrument, or contract, having regard to the context*

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<sup>12</sup> Ngalwana, VR. "Corporate Taxation and the Utilization of Assessed Losses in South Africa." South African Mercantile Law Journal 10, (1998): 193-220 at 203.

<sup>13</sup> De Koker, AP. and Williams, RC. *Silke on South African Income Tax* at 25.1 [2019, October].

<sup>14</sup> *Natal Joint Municipal Pension Fund v Endumeni Municipality* [2012] 2 All SA 262 (SCA) at 18.

<sup>15</sup> Ibid.

*provided by reading the particular provision or provisions in the light of the document as a whole and the circumstances attendant upon its coming into existence.*

*Whatever the nature of the document, consideration must be given to the language used in the light of the ordinary rules of grammar and syntax; the context in which the provision appears; the apparent purpose to which it is directed and the material known to those responsible for its production.*

*Where more than one meaning is possible each possibility must be weighed in the light of all these factors. The process is objective not subjective. A sensible meaning is to be preferred to one that leads to insensible or unbusinesslike results or undermines the apparent purpose of the document.” (own emphasis and footnotes omitted)*

The above principles were subsequently cited in approval by Wallis JA in *CSARS v Bosch and Another*<sup>16</sup> where he, among other things, had to deal with the interpretation of 'having exercised a right' in terms of section 8A, during which he stated the following:

*“The words of the section provide the starting point and are considered in the light of their context, the apparent purpose of the provision and any relevant background material. There may be rare cases where words used in a statute or contract are only capable of bearing a single meaning, but outside of that situation it is pointless to speak of a statutory provision or a clause in a contract as having a plain meaning. One meaning may strike the reader as syntactically and grammatically more plausible than another, but, as soon as more than one possible meaning is available, the determination of the provision's proper meaning will depend as much on context, purpose and background as on dictionary definitions or what Schreiner JA referred to as 'excessive peering at the language to be interpreted without sufficient attention to the historical contextual scene'.” (own emphasis and footnotes omitted)*

In the recent judgement of *Telkom SA SOC Ltd v CSARS*<sup>17</sup> the Supreme Court of Appeal once again approved the judgement of *Natal Joint Municipal Pension Fund v Endumeni Municipality*<sup>18</sup> and clarified that the context in which a statutory provision is determined is not the context applicable to the current facts of the scenario under review before the Court. The judgement clarified that the context is to be determined by reference to the process of law-making, which would enable the Court to arrive at its own independent interpretation of the statutory provision, which should be independent of the factual circumstances of the relevant scenario (i.e. the context should not be the commercial context in which a transaction took place, but the context in which the words were found in the relevant statute).<sup>19</sup>

It is thus clear from the aforementioned cases, that the current approach to the interpretation of statutes should be based on the four principles identified, which are:

- The wording of the section;
- Which should be considered in the light of the context in which they appear;
- The apparent purpose to which the provision is directed; and
- The relevant background and material known to the drafters of the relevant provision.

In applying these four principles to the primary research question of this study, the wording of section 20(1) should be considered in the light of the context in which section 20(1) appears (with this context being the context contained in the wording of section 20) and regard must be given

<sup>16</sup> *CSARS v Bosch and Another* [2015] 1 All SA 1 (SCA), 77 SATC 61.

<sup>17</sup> *Telkom SA SOC Ltd v CSARS* [2020] ZASCA 19 (25 March 2020).

<sup>18</sup> *Supra*. fn. 14.

<sup>19</sup> PricewaterhouseCoopers, 'The role of context in interpreting words in a statute' *Synopsis Tax today April 2020*. Available: <https://www.pwc.co.za/en/assets/pdf/synopsis/synopsis-april-2020.pdf> [2020, May 16]

to the purpose of section 20(1) (i.e. the set off and carry forward of assessed losses) and the relevant background and material known to the drafters of section 20. Please refer to Chapter 5 where these principles are applied to the primary research question in this study.

## 2.4 Section 11(a) – ‘in the production of income’

Section 11(a) contains the so-called general deduction formula used in determining the taxable income of a taxpayer. In order to qualify for a deduction in terms of section 11(a) the expenditure and losses must, among other things, be incurred “*in the production of income*”.<sup>20</sup> In terms of section 20(2) an assessed loss arises where the allowable deductions exceed the income in respect of which they are so admissible. In this regard an understanding of the different types of circumstances in which an assessed loss could arise would be relevant in interpreting section 20(1).

Section 11(a) (i.e. the general deduction formula) provides the following:

*“For the purpose of determining the taxable income derived by any person from carrying on any trade, there shall be allowed as deductions from the income of such person so derived—*

- a) *expenditure and losses actually incurred in the production of the income, provided such expenditure and losses are not of a capital nature” (own emphasis)*

Expenditure and losses incurred “*in the production of income*” will be deductible under section 11(a), provided that the other requirements of the section are complied with. The term “*in the production of income*” was held in *Port Elizabeth Electric Tramway Company Ltd v CIR*<sup>21</sup> to mean expenditure incurred for the “*purpose of earning income*”.<sup>22</sup> Furthermore, in *Sub-Nigel Ltd v CIR*<sup>23</sup> the principle was established that expenditure will not be disqualified as a deduction if it fails to produce any ‘income’<sup>24</sup> in the relevant tax year in which it was incurred.

Based on the aforementioned decisions, the general deduction formula allows for taxpayers to claim a deduction in determining their taxable income even though they derived no income during that year as long as it was, among other things, incurred for the purpose of earning income. This would essentially mean that an assessed loss could arise in two different scenarios.<sup>25</sup> The first scenario (hereafter referred to as the “First Scenario”) would be where the deductible expenditure incurred during the current year of assessment would exceed the income derived from trading during the same year of assessment. The second scenario (hereafter referred to as the “Second Scenario”) would be where expenditure qualified as a deduction, but with no corresponding trading income being earned during the same year of assessment (refer to *Sub-Nigel Ltd v CIR*<sup>26</sup> principle discussed in the previous paragraph). The assessed loss in the First Scenario would therefore be equal to the amount in which the allowable deductions would exceed the income in respect of which they are so admissible, whereas the assessed loss in the Second Scenario would be equal to the total amount of allowable deductions incurred during that year of assessment.

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<sup>20</sup> Section 1(1) defines the term ‘income’ to mean the amount remaining of the gross income of any person for any year or period of assessment after deducting therefrom any amounts exempt from normal tax under Part I of Chapter II.

<sup>21</sup> *Port Elizabeth Electric Tramway Company Ltd v CIR* 1936 CPD 241, 8 SATC 13 at 18.

<sup>22</sup> *Supra*. fn. 20.

<sup>23</sup> *Sub-Nigel Ltd v CIR* 1948 (4) SA 580 (A), 15 SATC 381 at 394.

<sup>24</sup> *Supra*. fn. 20.

<sup>25</sup> *Supra*. fn. 8 at 457.

<sup>26</sup> *Supra*. fn. 23.

The Second Scenario is especially relevant to the primary research question of this study in the event where such an assessed loss would occur for more than one year. In terms of the general deduction formula the expenditure would still qualify as a deduction during the subsequent years of assessment as long as it is incurred, among other things, for the purpose of earning income. In the chapters to follow it will be determined whether a company would be allowed to carry forward its balance of assessed loss determined at the end of its previous year of assessment to its current year of assessment in the event where it finds itself in such a Second Scenario for more than one year of assessment.

## **2.5 The term 'income' against which an assessed loss is set off**

The wording of section 20(1) provides that a balance of assessed loss is set off against the 'income' derived by the taxpayer. It is possible that an uncertainty could arise as to what is included within the term 'income' as contemplated in section 20(1) (i.e. whether it bears its defined meaning or whether it could bear another meaning). It is therefore relevant to determine the meaning of the term 'income' as used in section 20(1).

The majority and minority judgements in *Conshu (Pty) Ltd v CIR*<sup>27</sup> in the Appellate Division had opposing views in regard to the term 'income' against which an assessed loss is set off. In this regard the minority held that the term 'income' against which an assessed loss is set off "*bears its ordinary meaning as defined in section 1(1)*",<sup>28</sup> whereas the majority judgement held that the same term is not used in its defined term, but rather as "*income taxable but for the set off of assessed losses*".<sup>29</sup>

In this regard the effect of the majority view would be that a company which incurs a loss from its trading operations during a subsequent year of assessment would not be allowed to carry forward its balance of assessed loss determined at the end of its previous year of assessment, as it would in such an instance not have any available 'income which is taxable' which is to be set off against its balance of assessed loss. The effect of the minority view would allow for a trading loss made during the current year of assessment to be added to a balance of assessed loss determined at the end of the previous year of assessment. In the instance where the First Scenario occurs in a subsequent year of assessment, the balance of assessed loss would in terms of the minority judgement not be prevented from being carried forward to the current year of assessment, whereas the majority judgement would prevent such a balance of assessed loss from being carried forward. Whether the balance of assessed loss would be carried forward in the instance of the Second Scenario is essentially the primary research question in this study. Please refer to Chapter 4.7 where this judgement is discussed in more detail.

## **2.6 The trade requirement**

As mentioned in Chapter 1, a company which does not trade during a specific year of assessment forfeits its right to carry forward its balance of assessed loss from the preceding year of assessment. In this regard, although this study accepts that the trade requirement would be met, the 'trade' requirement is briefly discussed in this chapter.

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<sup>27</sup> *Conshu (Pty) Ltd v CIR* 1994 (4) SA 603 (A), 57 SATC 1.

<sup>28</sup> *Ibid* at 16.

<sup>29</sup> *Ibid* at 10.

The 'trade' requirement also only applies to companies as a result special treatment provided to other types of taxpayers in terms of section 20(2A)(a). In this regard, section 20(2A)(a) applies for taxpayers other than companies which provides that these taxpayers (i.e. taxpayers other than companies) are allowed to utilise an assessed loss even if no trading was conducted during a year of assessment.<sup>30</sup>

Section 1(1) defines the term 'trade' which includes:

*"every profession, trade, business, employment, calling, occupation or venture, including the letting of any property and the use of or the grant of permission to use any patent as defined in the Patents Act or any design as defined in the Designs Act or any trade mark as defined in the Trade Marks Act or any copyright as defined in the Copyright Act or any other property which is of a similar nature"*

It is also a well-established principle that the term trade should be given the widest possible interpretation and should embrace every profitable activity.<sup>31</sup> In this regard the mere intention to let a property would, for example, not amount to the carrying on of a trade, whereas the endeavour to let a property could constitute trading.<sup>32</sup>

As indicated in Chapter 1, for the purpose of this study it is accepted that the taxpayer conducts a recognisable trade and would therefore comply with the 'trade' requirement.

## **2.7 Section 103(2)**

The relevant court decisions discussed and analysed in Chapter 4 includes certain cases which dealt with section 103(2), but also includes relevant dictum in relation to the carrying forward of a balance of assessed loss. A description of the provisions of section 103(2) is therefore briefly set out below in order to provide some context to the relevance of the section 103(2) decisions in the light of the primary research question.

Section 103(2) deals with transactions, operations or schemes for purposes of avoiding or postponing liability for or reducing amounts of taxes on income. Its application could result in a company being disallowed from setting off any 'tainted income' derived from an agreement or change in shareholding as envisaged in section 103(2) against any balance of assessed loss brought forward from the previous year.

In order for section 103(2) to find application, it requires that all of the following circumstances must be present:

- There must an agreement affecting a company or a change in shareholding of a company;
- That resulted in either income or proceeds to have been received by or accrued to that company; and
- The purpose of the agreement or change in shareholding must be solely or mainly to utilise any balance of assessed loss in order to avoid or reduce the company's tax liability.

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<sup>30</sup> Supra. fn. 3.

<sup>31</sup> *Burgess v CIR* 1993 (4) SA 161 (A), 55 SATC 185 at 196.

<sup>32</sup> *ITC 777 (1953) 19 SATC 320 (T)* at 322.

The purpose of the section is clearly to prevent tax avoidance schemes. It does not impose an additional tax, but is aimed at schemes that are designed for the avoidance thereof.<sup>33</sup> This was also aptly stated by Botha JA during his judgement in *Glen Anil Development Corporation Ltd v SIR*:<sup>34</sup>

*"It should, in my view, therefore, not be construed as a taxing measure but rather in such a way that it will advance the remedy provided by the section and suppress the mischief against which the section is directed..."*

## **2.8 Conclusion**

An assessed loss could arise either as a result of the First Scenario (i.e. deductible expenditure which exceeds income) or as a result of the Second Scenario (i.e. deductible expenditure with no corresponding income in the same year of assessment). These different scenarios should however still be interpreted using the current approach to the interpretation of statutes.

The subsequent chapters will therefore apply the relevant principles and sections contained in the Act which has been discussed in this chapter in determining whether section 20(1) allows for the carrying forward of a balance of assessed loss determined at the end of a previous year of assessment to the current year of assessment, even though no 'income' had been derived from a company's trading activities during the current year of assessment.

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<sup>33</sup> *Glen Anil Development Corporation Ltd v SIR* 1975 (4) SA 715 (A), 37 SATC 319 at 334.

<sup>34</sup> *Ibid.*

## CHAPTER 3: SARS' VIEW

### 3.1 Introduction

As mentioned in Chapter 1.1, SARS is of the view that section 20(1) contains both the 'trade' and 'income' requirement, but accepts that this may have some unintended consequences.<sup>35</sup> In this regard SARS may under certain circumstances make a concession for taxpayer companies which would still allow for them to carry forward their balance of assessed loss from the preceding year of assessment, even though, according to SARS' view, such a company technically does not in terms of the Act qualify for carrying forward its balance of assessed loss. The purpose of this chapter is to briefly discuss the circumstances in which SARS may provide a concession to taxpayer companies as well as the status of SARS' interpretation notes in interpreting legislation in our courts.

### 3.2 Interpretation Note No 33

In terms of this Interpretation Note, SARS is willing to concede that, under certain circumstances a company would be allowed to carry forward its balance of assessed loss from the preceding year of assessment as long as the taxpayer proved that it had carried on a trade during the current year of assessment, even though it had derived no income from the carrying on of that trade. In this regard SARS is effectively willing to 'ignore' its view of the 'income' requirement, provided that certain criteria are met.<sup>36</sup>

The relevant criteria in respect of the concession provided by SARS is that this concession would only be available in circumstances where it is clear that the company had indeed been carrying on a trade and that the reason for the company not having earned any income during the relevant year of assessment must be incidental or as a result of the nature of the taxpayer's trading activities.<sup>37</sup> In this regard SARS makes it clear that it would apply an objective test in determining whether the taxpayer had traded during the relevant year of assessment in terms of which SARS would not accept a mere intention to trade and would also not accept preparatory activities in relation to a taxpayer's trade.<sup>38</sup> SARS has provided no guidance in this Interpretation Note as to which activities would constitute preparatory activities, but SARS clearly states that the absence of earning income from the taxpayer's trade may indicate that the taxpayer did not trade during the relevant year of assessment and that the taxpayer would have to discharge the onus that it did in fact trade during the relevant year of assessment.<sup>39</sup>

An example is provided where a pecan nut farming company would be allowed to carry forward its balance of assessed loss determined during its first four years of assessment for set off against the income earned during its fifth year of assessment, even though it had only started to earn income during its fifth year of assessment.<sup>40</sup> SARS explains that the reason for not deriving any income during its first four years of assessment is clearly due to the nature of the taxpayer's trading activities and would therefore qualify for the concession provided by SARS.<sup>41</sup>

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<sup>35</sup> Supra. fn. 9.

<sup>36</sup> Ibid.

<sup>37</sup> Ibid.

<sup>38</sup> Ibid.

<sup>39</sup> Ibid.

<sup>40</sup> Ibid.

<sup>41</sup> Ibid.

### 3.3 Status of SARS' Interpretation Notes

Although Interpretation Note No 33<sup>42</sup> provides SARS' view and its application thereof in respect of the carrying forward of assessed losses (which includes the concession provided to taxpayer companies under certain circumstances), it is specifically stated in the judgement of *ITC 1830*<sup>43</sup> that SARS "cannot (and clearly did not intend to) change the law by making concessions to address unintended results".

Furthermore, in regard to the impact of SARS' interpretation notes on the interpretation of tax laws, it was held in *Marshall NO and Others v CSARS*<sup>44</sup> that our courts should interpret legislation independently and should therefore not have regard to SARS' interpretation notes when interpreting legislation. In this regard the Constitutional Court stated the following:<sup>45</sup>

*"Why should a unilateral practice of one part of the executive arm of government play a role in the determination of the reasonable meaning to be given to a statutory provision? It might conceivably be justified where the practice is evidence of an impartial application of a custom recognised by all concerned, but not where the practice is unilaterally established by one of the litigating parties. In those circumstances it is difficult to see what advantage evidence of the unilateral practice will have for the objective and independent interpretation by the courts of the meaning of legislation, in accordance with constitutionally compliant precepts. It is best avoided."* (footnotes omitted)

Based on the above, the view taken by SARS in its Interpretation Note No 33<sup>46</sup> and any concessions provided by SARS in terms thereof would in any event not determine the interpretation of the law in our courts (unless of course such an interpretation note evidences a practice generally prevailing). In this regard the judgement in *ITC 1830*<sup>47</sup> (which is discussed in Chapter 4.11) accords with the principle held in the Constitutional Court's judgement in *Marshall NO and Others v CSARS*,<sup>48</sup> in which SARS' interpretation notes are essentially of no importance in interpreting legislation in our courts.

### 3.4 Conclusion

As held in the above-mentioned cases, SARS' interpretation notes would therefore not have any bearing in a court of law in which the interpretation of the law is the issue at hand. In this regard the concession, provided by SARS under certain circumstances, which is in essence a concession in respect of the 'income' requirement, would therefore not influence a court's decision in regard to its interpretation as to whether a company would be allowed to carry forward its balance of assessed loss. An important factor is however the judgements held in our courts in this regard which is analysed in Chapter 4.

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<sup>42</sup> Ibid.

<sup>43</sup> *ITC 1830* (2007) 70 SATC 123 (G) at 27.

<sup>44</sup> *Marshall NO and Others v CSARS* 2018 (7) BCLR 830 (CC), 80 SATC 400.

<sup>45</sup> Ibid at 10.

<sup>46</sup> Supra. fn. 9.

<sup>47</sup> Supra. fn. 43 at 27.

<sup>48</sup> Supra. fn. 44.

## CHAPTER 4: SOUTH AFRICAN CASE LAW ON ASSESSED LOSSES

### 4.1 Introduction

The purpose of this chapter is to analyse the relevant views held in the South African courts in the context of section 20(1) in order to determine whether section 20(1) provides for the carrying forward of any balance of assessed loss from the preceding year of assessment even though the taxpayer derived no income from trading during its current year of assessment. In order to consider the principle of *stare decisis* and to provide the necessary context for the reliance placed on the judgements of earlier cases by our later court decisions, it would therefore be necessary that the analysis in this chapter should start with the older decisions and then progress to the more recent decisions. Furthermore, as discussed in Chapter 1, this chapter only considers the cases that are deemed relevant to this study in the context of the primary research question.

### 4.2 Income Tax Case No 664

#### 4.2.1 Judgement

In *ITC 664*,<sup>49</sup> which was delivered on 13 September 1948 in the Special Court for Hearing Income Tax Appeals (hereafter referred to as the "Special Court"), the taxpayer company had been trading up to the year 1929 and at that stage had determined an accumulated assessed loss. During the period from 1929 to 1945 the taxpayer did not carry on any trade and had derived no income from trading. The issue before the Court was whether the taxpayer was allowed to carry forward its balance of assessed loss from its 1929 year of assessment onwards and up to its 1945 year of assessment.

The taxpayer had contended that it was entitled in terms of section 11(3) of the Income Tax Act No 40 of 1925 and Act No 31 of 1941<sup>50</sup> to have had its assessed loss carried forward in each of the following years of assessment from 1929 up and until its 1945 year of assessment, whereas the Commissioner had contended that the taxpayer's assessed loss from its 1930 to 1945 years of assessment was to be nil.

The Court held that, as the taxpayer had not traded and had received no income from trade, it was unable to invoke the relevant set off provision, and the appeal was accordingly dismissed. The following extract of Ingram CJ's judgement is deemed relevant for the purpose of this study:<sup>51</sup>

*"The next question to be determined is what will be the position if there is no income in the next succeeding year. Here it is important to note that the section operates by way of set-off, i.e., the apposition of one amount against the other. It does not envisage the addition of the 'balance of assessed loss' to a loss on the year's trading or its accumulation therewith. Section 11(1) provides that there shall be set off against the income the amounts permitted under sub-section (3).*

*It follows, therefore, that in any given year there must be some income, i.e., an amount received in terms of section 7, against which the set-off can operate. Further, the income must be derived from trade."*

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<sup>49</sup> *ITC 664* (1948) 16 SATC 125 (U).

<sup>50</sup> These provisions were substantially similar to the current section 20(1) and (2) of the 1962 Act according to Ngalwana in his commentary in *Supra*. fn. 12 at 199.

<sup>51</sup> *Supra*. fn. 49 at 126.

#### 4.2.2 Relevant commentary and analysis

According to Swart,<sup>52</sup> the suggestion made by Ingram CJ in *ITC 664*<sup>53</sup> that the addition of a balance of assessed loss to the current year's trading loss is not envisaged by the relevant provision, does not square with the wording of the provision. This is then explained by Swart when stating that the basic requirement in order for set off to operate is that the taxpayer should be carrying on a trade and that it does not relate to the requirement for the taxpayer to derive income which is taxable.<sup>54</sup>

Ngalwana<sup>55</sup> on the other hand, takes a contrary view in which he states that the accumulation of the preceding year's assessed loss with a trading loss incurred during the current year of assessment is not consistent with the wording of the relevant provision. Ngalwana further explains his view by stating that the section deals with two amounts (with one being a positive balance and the other being a negative balance) which are deducted from one another, thus resulting in a smaller loss to be carried forward to the following year of assessment (or alternatively no further loss to be carried forward to the following year of assessment).<sup>56</sup> In comparing the provisions of the Income Tax Act No 40 of 1925 and Act No 31 of 1941 to those of section 20 of our current Act (i.e. Income Tax Act No 58 of 1962) Ngalwana notes that the phrase 'deducted from' has been omitted in section 20.<sup>57</sup> In this regard he concludes that the omission thereof is insignificant and otiose as, in his view, the two phrases included in the previous provisions were used as synonyms and that a disjunctive construction would lead to the untenable result that they are mutually exclusive (i.e. with one being the opposite of the other).<sup>58</sup> Ngalwana also explains the semantic meaning of the term 'set off' as examined in section 20(1) of which he stated the following:<sup>59</sup>

*"The section clearly provides for the set-off, against the income, of any assessed loss or balance of assessed loss. The term 'set-off' envisages a pitting of two opposites against each other.*

*Semantically, one cannot set off a positive figure against another in much the same way as one cannot set off one negative figure against another. One can perhaps add two positives together and two negatives together. The result of a set-off (really, a synonym for subtraction) ought to be a smaller number than the one with which one started, whether such result is a positive or negative figure.*

*An arithmetical process which results in a larger number of the same kind as that with which one started (negative and negative, or positive and positive), therefore, is not set-off. A 'set-off' of one negative against another is effectively an addition, not a set-off. So bringing together one assessed loss with another, which results in a larger assessed loss, cannot be called set-off. Rather, it is an addition.*" (own emphasis)

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<sup>52</sup> Supra. fn. 4 at 125.

<sup>53</sup> Supra. fn. 49.

<sup>54</sup> Supra. fn. 4 at 125.

<sup>55</sup> Supra. fn. 12 at 201.

<sup>56</sup> Ibid.

<sup>57</sup> Section 11(1) of the earlier statutes read: "For the purpose of determining the taxable income derived by any person from carrying on any trade within the Union, there shall be deducted from or set-off against the income of such person so derived as defined by section seven the amounts set out in this section".

<sup>58</sup> Supra. fn. 12 at 203.

<sup>59</sup> Ibid.

Ingram CJ also makes a statement that there must be some income in a given year for the set off provisions to be able to operate.<sup>60</sup> In this regard Olivier<sup>61</sup> remarks in her commentary on *ITC 664*<sup>62</sup> that this view was held *obiter*.

The Court's judgement in this case included a discussion on both the 'trade' and 'income' requirement. Its decision pertaining to the 'income' requirement (although *obiter*) serves as the basis for some commentators who hold the view that an 'income' requirement exists, whereas other commentators do not regard this to be the case.

### 4.3 SA Bazaars (Pty) Ltd v CIR

#### 4.3.1 Judgement

In *SA Bazaars (Pty) Ltd v CIR*,<sup>63</sup> which was delivered on 30 September 1952 in the Appellate Division, the taxpayer company incurred trading losses for a number of years and eventually closed down its business in 1941. During the period from 1941 to 1947 the taxpayer did not carry on any trade and sought to set off the income earned during its 1948 and 1949 years of assessment against its balance of assessed loss brought forward from the preceding years of assessment. The issue before the Court was whether the taxpayer was allowed to carry forward its balance of assessed loss during the subsequent years of assessment for it to be set off against the income earned during its 1948 and 1949 years of assessment.

The taxpayer had contended that its assessed loss determined in the previous years of assessment should have been carried forward in each of its each following years of assessment, whereas the Commissioner had contended that its assessed loss is to be nil in respect of its 1944 to 1947 years of assessment.

The Court held that, as the taxpayer did not carry on any trade during its 1944 year of assessment, it was not allowed to carry forward its assessed loss to the following years of assessment. It was further not necessary for the Court to decide whether the taxpayer would have been entitled to carry forward its balance of assessed loss if it had been carrying on a trade, but derived no income therefrom. The following extract of Centlivres CJ's judgement is deemed relevant for the purpose of this study:<sup>64</sup>

*"Under that sub-section a deduction or set-off is admissible only against income derived from carrying on a trade. As the appellant carried on no trade during the year under consideration it was not competent for it to set off in its income tax return for that year the balance of assessed loss incurred by it in previous years.*

*It is not necessary for the purpose of this case to decide whether the appellant would have been entitled to set off that balance in respect of the year ending on 30th June, 1944, if during that year it had carried on a trade but earned no income - cf. Sub-Nigel Ltd. v Commissioner for Inland Revenue, 1948(4) S.A. 580 (A.D.) at 589 and 590."* (own emphasis)

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<sup>60</sup> Supra. fn. 49 at 126.

<sup>61</sup> Supra. fn. 3 at 390.

<sup>62</sup> Supra. fn. 49.

<sup>63</sup> *SA Bazaars (Pty) Ltd v CIR* 1952 (4) SA 505 (A), 18 SATC 240.

<sup>64</sup> *Ibid* at 245.

### 4.3.2 Relevant commentary and analysis

The judgement in *SA Bazaars (Pty) Ltd v CIR*<sup>65</sup> laid down the principle that a taxpayer which does not trade during a specific year of assessment forfeits its right to carry forward its balance of assessed loss from the preceding year of assessment. In this regard Ngalwana remarks that it is not a requirement for a company to cease trading for a number of years, but that the failure to trade for one entire year of assessment would be sufficient for a taxpayer to forfeit its right to carry forward its balance of assessed loss from the preceding year of assessment.<sup>66</sup> Centlivres CJ, however, left open the question whether a taxpayer would have been entitled to carry forward its balance of assessed loss if it had carried on a trade but derived no income therefrom.<sup>67</sup>

The Court's judgement in this case only considered the 'trade' requirement and laid down the principle that a taxpayer company forfeits its right to carry forward its balance of assessed loss from the preceding year of assessment in the event that it did not trade for an entire year of assessment (i.e. the 'trade' requirement). In regard to the 'trade' requirement for taxpayers other than companies, this decision and the application thereof has been overridden in terms of section 20(2A)(a) which provides that such a taxpayer is still allowed in certain circumstances to utilise an assessed loss even if no trading was conducted during a year of assessment. The 'income' requirement was mentioned but was not decided on. This case therefore does not assist in answering the primary research question to this study.

## **4.4 Income Tax Case No 777**

### 4.4.1 Judgement

In *ITC 777*,<sup>68</sup> which was delivered on 16 October 1953 in the Transvaal Special Court, the taxpayer company owned certain fixed property that it had endeavoured to let during its 1948 year of assessment, but had failed to secure any rentals and thus derived no rental income therefrom during its 1948 year of assessment. In determining the taxpayer's assessed loss for its 1948 year of assessment, the Commissioner disallowed the carrying forward of its assessed loss determined at the end of its previous year of assessment (i.e. 1947) on the basis that the taxpayer did not carry on any trade during its current year of assessment (i.e. 1948). The issue before the Court was whether the taxpayer traded during its 1948 year of assessment and whether it he was allowed to carry forward the assessed loss incurred during its 1947 year of assessment.

The taxpayer had contended that it had traded during its 1948 year of assessment, whereas the Commissioner contended that the taxpayer did not carry on a trade during its 1948 year of assessment.

The Court held that the endeavour to let the property owned by the taxpayer constituted trading and therefore the taxpayer was entitled to carry forward its assessed loss incurred during its previous year of assessment (i.e. 1947) to the following year of assessment. The Court further stated that it was not contended that the taxpayer was not allowed to carry forward its balance

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<sup>65</sup> Ibid.

<sup>66</sup> Supra. fn. 12 at 196.

<sup>67</sup> Ibid at 200.

<sup>68</sup> Supra. fn. 32.

of assessed loss to the following year of assessment on the basis that it had earned no income during its 1948 year of assessment.

#### 4.4.2 Relevant commentary and analysis

In discussing *ITC 777*<sup>69</sup>, Meyerowitz<sup>70</sup> remarks that the 'income' requirement was apparently not contended by the Commissioner. He further states that it is indeed considered that a taxpayer would not be precluded from carrying forward its balance of assessed loss to the following year of assessment in the event where such a taxpayer had traded, but derived no income therefrom.

The Court's judgement in this case only considered the 'trade' requirement. In regard to the 'income' requirement, it should be noted that although the taxpayer was allowed to carry forward its balance of assessed loss to the following year of assessment even though it had derived no income from its trading activities during that year of assessment, Nesor J did not decide on this point as it was not contended by the Commissioner. This case therefore does not provide authority that the 'income' requirement does not exist, but it is worth noting that in this instance the carrying forward of the taxpayer's assessed loss was not disallowed.

### **4.5 CIR v Louis Zinn Organization (Pty) Ltd**

#### 4.5.1 Judgement

In *CIR v Louis Zinn Organization (Pty) Ltd*,<sup>71</sup> which was delivered on 30 September 1958 in the Appellate Division, the taxpayer company had incurred a trading loss during its 1954 year of assessment and also entered into a compromise with its trade creditors in March 1954 (i.e. during its 1954 year of assessment) which resulted in a gain to be recognised in its financial statements (i.e. the amount of debt discharged that exceeded the payment made in respect of the debt was recognised as a gain in its financial statements). In determining the taxpayer's balance of assessed loss at the end of its 1954 year of assessment, the Commissioner deducted the gain recognised in respect of the compromise with the taxpayer's trade creditors from its trading loss incurred during its 1954 year of assessment. The issue before the Court was whether the gain recognised on the compromise with the taxpayer's trade creditors should have been taken into account in reducing the balance of assessed loss to be carried forward to the following year of assessment.<sup>72</sup>

The taxpayer had contended, among other things, that its assessed loss resulting from its trading loss for its 1954 year of assessment should not have been reduced by the gain recognised in respect of the compromise with its trade creditors, as the gain accrued to the taxpayer during the same year of assessment in which the trading loss was incurred. The Commissioner contended, among other things, that the gain recognised in respect of the compromise with the taxpayer's trade creditors should be taken into account in reducing the taxpayer's balance of assessed loss to be carried forward to the following year of assessment.

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<sup>69</sup> Ibid.

<sup>70</sup> Meyerowitz, D. "Particular Deductions." Chapter 12, In *Meyerowitz on Income Tax*. Vol. 2007 - 2008, 65, 2008.

<sup>71</sup> *CIR v Louis Zinn Organization (Pty) Ltd* 1958 (4) SA 478 (A) , 22 SATC 85.

<sup>72</sup> Section 11(3) of the Income Tax Act No 31 of 1941 (which is substantially similar to section 20(1) of the Act) contained proviso that has been removed from section 20(1) and which is now dealt with in section 19 and paragraph 12A of the Eighth Schedule to the Act. The proviso read: "...the balance of assessed loss shall be reduced by the amount or value of any benefit received by or accruing to a person resulting from a concession granted by, or a compromise made with his creditors whereby his liabilities to them have been reduced or extinguished, provided such liabilities arose in the ordinary course of trade..."

The Court held that reduction in the balance of assessed loss to be carried forward to the following year of assessment takes place at the stage when the balance is determined for use in the future, and accordingly held that the Commissioner was correct in reducing the gain recognised on the compromise with the taxpayer's trade creditors during its current year of assessment. The following extract of Schreiner ACJ's judgement is deemed relevant for the purpose of this study:<sup>73</sup>

*"Wherever there has been a trading loss in the tax year, or where there has been a balance of assessed loss brought forward from the previous year, there has to be a determination of the balance of assessed loss to be carried forward into the next year.*

*There may have been a profit in the tax year but not large enough to obliterate the balance of assessed loss carried over from the previous year. Then the new balance of assessed loss will be smaller than the previous one.*

*If there has been a working loss in the tax year the balance to go forward will be increased. If there has been no previous balance the assessed loss in the tax year will be the balance of assessed loss carried forward. The point to keep in mind is that, although at the stage where it is to be used, i.e. when it is to be set off against a profit, a balance of assessed loss looks back to the past, at the stage where it is being determined, i.e. when its amount is being calculated, it looks forward to the future when it will be used. At the determination stage it is being prepared for future use, and it has then no effect on the taxpayer's liability in respect of the tax year for which the relative notice of assessment is issued."* (own emphasis)

#### 4.5.2 Relevant commentary and analysis

The judgement in *CIR v Louis Zinn Organization (Pty) Ltd*<sup>74</sup> dealt with the impact of a compromise with a taxpayer's trade creditors on its balance of assessed loss (which is now dealt with in section 19 of the Act and paragraph 12A of the Eighth Schedule to the Act).<sup>75</sup> The relevance of this case to the primary research question of this study is the methodology for determining a taxpayer's balance of assessed loss, as described by Schreiner ACJ.<sup>76</sup> It is, however, submitted that Schreiner ACJ suggested *obiter* that an assessed loss in the current year of assessment can be added to a balance of assessed loss carried forward from the preceding year of assessment.<sup>77</sup>

In discussing the underlying principles relating to the set off of an assessed loss, Swart<sup>78</sup> explains, with reference to the predecessors of section 20(1),<sup>79</sup> that the set off of an assessed loss was subject to the same basic principles in respect of allowable deductions.<sup>80</sup> In this regard he remarks that a balance of assessed loss brought forward from the preceding year of assessment was taken into account in the same manner as any other qualifying deductions. Swart then further explains that a balance of assessed loss could therefore still have been carried forward from the preceding year of assessment even where the taxpayer had made an assessed loss in the current year of assessment. In this regard the current year's assessed loss is effectively added to the balance of assessed loss determined at the end of the previous year of assessment, in order to determine a new and larger balance of assessed loss that is to be carried forward into the following year of assessment.<sup>81</sup> Ngalwana, on the other hand, takes a contrary view in that

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<sup>73</sup> Supra. fn. 71 at 95.

<sup>74</sup> Ibid.

<sup>75</sup> Section 19 deals with the income tax consequences a concession or compromise in respect of a debt while paragraph 12A deals with the capital gains tax implications thereof.

<sup>76</sup> Supra. fn. 71 at 95.

<sup>77</sup> Supra. fn. 12 at 200.

<sup>78</sup> Supra. fn. 4 at 124.

<sup>79</sup> Section 17(2) of the Income Tax Act No 41 of 1917 and section 11(3) of the Income Tax Act No 40 of 1925 and Act No 31 of 1941.

<sup>80</sup> Refer to the discussion of section 11(a) in Chapter 2.4 above.

<sup>81</sup> Supra. fn. 4 at 124.

he remarks that the addition of the preceding year's balance of assessed loss to the current year's assessed loss is not consistent with the wording of the predecessors of section 20(1).<sup>82</sup>

The Court's judgement in this case, among other things, dealt with the methodology of determining a taxpayer's balance of assessed loss. It did not, however, include a discussion on either the 'trade' or the 'income' requirement. However, in terms of the methodology described by Schreiner ACJ (although *obiter*), an assessed loss determined in the current year of assessment is effectively added to the balance of assessed loss determined at the end of the previous year of assessment, in order to determine a new and larger balance of assessed loss that is to be carried forward into the following year of assessment. Although this does not specifically relate to the primary research question to this study (i.e. the 'income' requirement), it does provide the principle that a balance of assessed loss would be increased by an assessed loss determined during the current year of assessment.

## **4.6 New Urban Properties (Pty) Ltd v SIR**

### 4.6.1 Judgement

In *New Urban Properties (Pty) Ltd v SIR*,<sup>83</sup> which was delivered on 9 November 1965 in the Appellate Division, the taxpayer company had determined a balance of assessed loss in respect of its 1958 year of assessment. During January 1959 there was a change in the shareholding of the company, which resulted in the taxpayer entering into certain agreements from which the taxpayer derived income during its 1959 year of assessment. Prior to the change in shareholding the taxpayer had not traded and the aforementioned trading activities only started pursuant to the change of shareholding in the company. The taxpayer sought to set off the income earned during its 1959 year of assessment against the balance of assessed loss brought forward from its previous year of assessment, but in the appeal to the Special Court it was admitted on behalf of the taxpayer that the provisions of 90(1)(b) of the Income Tax Act No 31 of 1941 (which is now included in section 103(2)) applied, therefore such a set off was disallowed. The Secretary who disallowed the set off, also determined that no balance of assessed loss was to be carried forward to the following year of assessment. The issue before the Court was whether the taxpayer was allowed to carry forward its balance of assessed loss to the following year of assessment.

The taxpayer had contended that, although section 90(1)(b) (now section 103(2)) applied in disallowing any set off during its 1959 year of assessment, it was still allowed to carry forward its balance of assessed loss which should be available for set off against future income, whereas the Secretary had contended that the balance of assessed loss should be nil.

The Court held that, as a result of the application of section 90(1)(b) (now section 103(2)) there was no income or loss from trading against which the machinery of setting off an assessed loss could operate, and as a result thereof the essential continuity of striking a balance had been interrupted (i.e. the balance of assessed loss was held to be nil).

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<sup>82</sup> Supra. fn. 12 at 201.

<sup>83</sup> *New Urban Properties (Pty) Ltd v SIR* 1966 (1) SA 215 (A) , 27 SATC 175.

The following extract of Beyers JA's judgement is deemed relevant for the purpose of this study (which was stated after he had referred to the decisions of *CIR v Louis Zinn Organization (Pty) Ltd*<sup>84</sup> and *SA Bazaars (Pty) Ltd v CIR*):<sup>85,86</sup>

*"In other words, not having traded in that year, and therefore not having earned any income from trade (nor having incurred a trading loss - cf. The Louis Zinn case, supra, and the case of Sub-Nigel, Ltd. v Commissioner for Inland Revenue, 1948(4) S.A. 580 (A.D.) at 590, referred to in the S.A. Bazaars case) there was nothing against which the balance of assessed loss could be set off in that year." (own emphasis and footnotes omitted)*

Thereafter, he made the following statement:<sup>87</sup>

*"According to both decisions subsection(3) envisages a continuity in setting off an assessed loss in every year succeeding the year in which it was originally incurred, so that in each succeeding year a balance can be struck to the satisfaction of the Secretary which can then be carried forward from year to year until it is exhausted; if, for any reason, the assessed loss cannot be so set off and balanced in any particular year, there is then no 'balance of assessed loss' for that year which (viewed from that year of assessment) can be carried forward to the succeeding year, or (viewed from the succeeding year of assessment) there is no 'balance of assessed loss which has been carried forward from the preceding year of assessment;' in other words, the essential continuity has been fatally interrupted." (own emphasis)*

#### 4.6.2 Relevant commentary and analysis

This case confirmed that section 20(1) requires a continuity of trading between the incurring of the assessed loss and the carrying forward thereof into the following year of assessment.<sup>88</sup> It further confirms that any interruption of this continuity will result in the assessed loss being forfeited as there would be no balance of assessed loss which can be carried forward to the next year.<sup>89</sup> Beyers JA also explained that the failure to trade by the taxpayer in the *SA Bazaars* case<sup>90</sup> resulted in the interruption of the required continuity, whereas the interruption in this case occurred as a result of the operation of section 90(1)(b) (now section 103(2)) which prohibited the machinery of setting of an assessed loss from operating.

It should also be noted that the first quote in Beyers JA's judgement above, refers to the requirement for a company to trade in order for the set off of an assessed loss to operate (i.e. a balance cannot be struck where there is no income or loss from trading in the particular year).<sup>91</sup> In this regard one should remember that a loss from trading could arise either as a result of the First Scenario (i.e. deductible expenditure which exceeds income) or as a result of the Second Scenario (i.e. deductible expenditure with no corresponding income in the same year of assessment).<sup>92</sup> It is, however, submitted that Beyers JA's view that an assessed loss in the current year of assessment can be added to a balance of assessed loss carried forward from the preceding year of assessment was held *obiter*.<sup>93</sup>

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<sup>84</sup> Supra. fn. 71.

<sup>85</sup> Supra. fn. 63.

<sup>86</sup> Supra. fn. 83 at 183.

<sup>87</sup> Ibid.

<sup>88</sup> Williams, RC. "Deductions: General Principles; Assessed losses of prior years." Chap 9, In *Income Tax in South Africa - Cases and Materials*. Vol. Fourth Edition, 525, 2015.

<sup>89</sup> Supra. fn. 4 at 132.

<sup>90</sup> Supra. fn. 63.

<sup>91</sup> Supra. fn. 8 at 457.

<sup>92</sup> Refer to the discussion of section 11(a) in Chapter 2.4 above.

<sup>93</sup> Supra. fn. 12 at 200.

The Court's judgement in this case only considered the 'trade' requirement, as the carrying forward of the taxpayer's balance of assessed loss was disallowed on the basis that there were no other trading activities conducted by the taxpayer (other than the trading activities that arose as a result of the change in shareholding) against which a balance could be struck and carried forward to the following year of assessment. Although the Court's judgement did not include a discussion on the 'income' requirement, it did, however, make a reference to *CIR v Louis Zinn Organization (Pty) Ltd*<sup>94</sup> in which a loss from trading in the current year of assessment would be added to the balance of assessed loss determined at the end of the previous year of assessment (refer to the first quote in Beyers JA's judgement above).

## **4.7 Conshu (Pty) Ltd v CIR**

### 4.7.1 Judgement

In *Conshu (Pty) Ltd v CIR*,<sup>95</sup> which was delivered on 2 September 1994 in the Appellate Division, the taxpayer company had suffered a loss from its trading operations (constituting the activities of a tyre retreader and dealer) and had determined a balance of assessed loss. During its 1985 year of assessment, the taxpayer's results were even worse and as a result a new and larger balance of assessed loss was determined at the end of its 1985 year of assessment. On the last day of the taxpayer's 1985 year of assessment, the taxpayer entered into an agreement that fell within the provisions of section 103(2). The aforementioned agreement consisted of the acquisition of certain trading assets and liabilities (hereafter referred to as the "transferred assets"). The taxpayer also disposed of the bulk of its business, but the tyre business was retained.

During its 1986 year of assessment the taxpayer sought to set off its income earned during the 1986 year of assessment against its balance of assessed loss brought forward from the previous year of assessment. Initially the Commissioner allowed the set off, but subsequently simultaneously issued two revised assessments in relation to its 1986 year of assessment. The first revised assessment consisted of a reduced assessment that set off the income derived from the tyre business against the balance of assessed loss carried forward from the preceding year of assessment (hereafter referred to as the "untainted income"). The second revised assessment consisted of an additional assessment which dealt with the income earned as a result of the transferred assets (hereafter referred to as the "tainted income"). The effect of the additional assessment was to prevent the tainted income from being set off against the balance of assessed loss carried forward from the previous year of assessment.

The issue before the Court was whether the Commissioner was allowed to apply the provisions of section 103(2) in a year of assessment which is subsequent to the year in which the agreement contemplated in section 103(2) was entered into. The taxpayer had contended that the Commissioner should have applied the provisions of section 103(2) in the relevant year of assessment in which the agreement, as contemplated in section 103(2), was entered into (i.e. during its 1985 year of assessment), whereas the Commissioner contended that it could apply the anti-avoidance provision during its 1986 year of assessment.

The majority of the Court held that section 103(2) could only be applied by the Commissioner for the first time during its 1986 year of assessment, which is the first year of assessment in which

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<sup>94</sup> Supra. fn. 71.

<sup>95</sup> Supra. fn. 27.

the taxpayer had attempted to set off the tainted income against its balance of assessed loss brought forward from the preceding year of assessment, and as a result the appeal was dismissed.

Furthermore, the majority of the Court (per Harms JA) held that the term 'income', against which an assessed loss is set off, is not used in its defined term,<sup>96</sup> but rather as "*income taxable but for the set off of assessed losses*".<sup>97</sup> During the judgement of E M Grosskopf JA (minority view) he stated the following in response to the view held by Harms JA (majority view):<sup>98</sup>

*"There is nothing in the Act to indicate that the set-off can operate only after the deductions have been made, and only if there then remains a profit, as suggested by Harms JA. The mere fact that the provisions regarding deductions appear in sections of the Act before s 20 cannot lead to this result....*

*This result would be so inconsistent with the scheme of the Act that it would require clear language to achieve it. In my view both the language of the Act, and the clear policy underlying it, lead to a different conclusion ....*

*It follows that 'income' in s 20 bears its ordinary meaning as defined in s 1. Section 20 does not require for its application that the taxpayer must have made a profit during the relevant year of assessment...*

*For present purposes it is sufficient to emphasise that the set-off of an assessed loss against income under s 20(1)(a) is permitted even if the taxpayer did not make a trading profit during the year of assessment in question."(own emphasis)*

In reaching the aforementioned conclusion, E M Grosskopf JA (minority view) gave an example of a company which, during its second year of assessment, earned income of R 20,000 and incurred deductible expenditure of R 30,000 and also had a balance of assessed loss of R 50,000. In his view a new balance of assessed loss of R 60,000<sup>99</sup> would have been determined and he also stated that, to his knowledge, this was the manner in which assessed losses have been applied in the past.<sup>100</sup>

#### 4.7.2 Relevant commentary and analysis

In this judgement the majority and minority judgements had opposing views with regards to the term 'income' against which an assessed loss is set off. The majority held that the term 'income' against which an assessed loss is set off, is not used in its defined term, but rather as "*income taxable but for the set off of assessed losses*".<sup>101</sup> The minority held that the same term "*bears its ordinary meaning as defined in section 1(1)*".<sup>102</sup>

It is submitted that the majority held *obiter* that an assessed loss could only be carried forward to the following year if the trading conducted in the current year resulted in income which is taxable.<sup>103</sup> Ngalwana concurs with the majority judgement when he remarks that at least some income which is taxable is required in order for the machinery of setting off an assessed loss to

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<sup>96</sup> Supra. fn. 20.

<sup>97</sup> Supra. fn. 27 at 10.

<sup>98</sup> Ibid at 16.

<sup>99</sup> Calculated as: (R 20,000 - R 30,000) - R 50,000.

<sup>100</sup> Supra. fn. 27 at 16.

<sup>101</sup> Ibid at 10.

<sup>102</sup> Ibid at 16.

<sup>103</sup> Olivier, L. "Set-Off of Assessed Losses: Uncertainty Continues ITC 1830 70 SATC 123." De Jure 42, no. 2 (2009): 327-330 at 328.

operate. In this regard Ngalwana also remarks that, even an amount of 1 cent constituting income which is taxable, would be sufficient in order to invoke the set off provisions.<sup>104</sup>

The minority's decision would essentially allow for an assessed loss made during the current year of assessment to be added to the balance of assessed loss determined at the end of the previous year of assessment.<sup>105</sup> The reason being that in the minority's view, section 20(1) does not require a taxpayer to have made a 'pre-tax profit' (i.e. income which is taxable) in order for a company to be allowed to carry forward its balance of assessed loss from the preceding year of assessment. The example provided by E M Grosskopf JA would in this instance be similar to the First Scenario (i.e. deductible expenditure which exceeds income). However, no example was provided by E M Grosskopf JA in regard to the Second Scenario (i.e. deductible expenditure with no corresponding income in the same year of assessment), which is essentially the primary research question in this study.

From the commentary made by Emslie and Davis<sup>106</sup> on *Conshu (Pty) Ltd v CIR*<sup>107</sup> it is clear that they both share the view held by the minority. In this regard Emslie and Davis go on to state the following:<sup>108</sup>

*"We concur, with respect, with E M Grosskopf JA's view that it would indeed be absurd if an assessed loss brought forward from the preceding year of assessment were irretrievably lost simply because a further loss were made in the current year. In our view not only would such an interpretation of s 20(1) be at odds with other decisions (which have countenanced the accumulation of assessed losses provided that a trade is carried on and everyday departmental practice, it would also fly in the face of common sense."* (own emphasis)

In this regard it is submitted that the interpretation of the minority judgement is to be preferred.<sup>109,110</sup> Furthermore, this view also accords with the methodology for establishing a balance of assessed loss as described by Schreiner ACJ in *CIR v Louis Zinn Organization (Pty) Ltd*.<sup>111</sup>

The Court's judgement in this case did not deal with the 'trade' requirement. With regards to the 'income' requirement the majority judgement concluded (albeit *obiter*) that the set off provisions in terms of section 20(1) could only apply if the trading conducted in the current year resulted in income which is taxable. The impact of the majority judgement on the primary research question of this study essentially answers the primary research question in the negative (i.e. in terms of the majority judgement it would mean that a company that carries on a trade without deriving any income which is taxable would therefore not be permitted to carry forward its balance of assessed loss from its preceding year of assessment). However, as this was merely submitted *obiter* and therefore not constituting the *ratio decidendi* of the judgement, it is not binding on any court. The minority judgement, which allows for the accumulation of assessed losses (i.e. which is envisaged in the First Scenario), did not explicitly answer the primary research question in the positive (i.e. the Second Scenario), but it provides an indication that this could be possible. Furthermore, the view of the minority judgment in respect of the term 'income' to which an assessed loss is set off against, is to be preferred.

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<sup>104</sup> Supra. fn. 12 at 205.

<sup>105</sup> Supra. fn. 4 at 123.

<sup>106</sup> Emslie, TS. and Davis, DM. "Assessed Losses." Chap. 17, In *Income Tax Cases and Materials*. Vol. Second Supplement to Third Edition, 863, 2011.

<sup>107</sup> Supra. fn. 27.

<sup>108</sup> Supra. fn. 106.

<sup>109</sup> Supra. fn. 13 at 8.125 – 8.127.

<sup>110</sup> Supra. fn. 9 at 4.2.1.

<sup>111</sup> Supra. fn. 71 at 95.

## 4.8 Robin Consolidated Industries Ltd v CIR

### 4.8.1 Judgement

In *Robin Consolidated Industries Ltd v CIR*,<sup>112</sup> which was delivered on 14 March 1997 in the Appellate Division, the taxpayer company was placed in liquidation during its 1987 year of assessment, in which it had disposed of its business under a "lock, stock and barrel" sale. The aforementioned sale, however, excluded certain assets which remained the property of the taxpayer. In order to dispose of its business as a going concern, the liquidators had to ensure continued trading within the company up to and including the effective date of the sale of its business. As a result of the aforementioned trading activities, the taxpayer was regarded as having traded during its 1987 year of assessment. As the taxpayer was running at a loss, it was in an assessed loss position at the end of its 1987 year of assessment. During its 1988 year of assessment (i.e. pursuant to the disposal of its business) there occurred two sales of goods in bond. The issue before the Court was whether the taxpayer had traded during its 1988 year of assessment and whether it was allowed to carry forward its balance of assessed loss determined during its 1987 year of assessment.

The taxpayer had contended, among other things, that the two sales of goods in bond constituted trading and therefore it was allowed to carry forward its balance of assessed loss determined at the end of its preceding year of assessment. The Commissioner had contended that the taxpayer had not traded during its 1988 year of assessment and therefore the taxpayer was not allowed to carry forward its balance of assessed loss determined during its 1987 year of assessment to any subsequent year of assessment.

The Court held that the liquidators had merely realised the goods and therefore the disposals did not constitute the carrying on of a trade. In this regard the Court held that the taxpayer forfeited its right to carry forward its assessed loss determined at the end of its 1987 year of assessment.

The following extract of Schutz JA's judgement is deemed relevant for the purpose of this study (which was explained by Schutz JA just after he had referred to the judgement of Centlivres CJ in *SA Bazaars (Pty) Ltd v CIR*):<sup>113,114</sup>

*"Two propositions appear from this passage: set-off is admissible only (a) against income derived from trade; and (b) where the balance of assessed loss has been carried forward from the preceding year."*

Also deemed relevant for the purpose of this study, Schutz JA referred to Beyers JA's judgement in *New Urban Properties (Pty) Ltd v SIR*<sup>115</sup> and stated the following:<sup>116</sup>

*"This passage makes explicit that a balance can be carried forward from any year only if a balance has been struck in that year, which clearly means: if an assessment has been issued for that year reflecting the balance of assessed loss at the end of it."*

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<sup>112</sup> *Robin Consolidated Industries Ltd v CIR* 1997 2 All SA 195 (A), 59 SATC 199.

<sup>113</sup> *Supra.* fn. 63.

<sup>114</sup> *Supra.* fn. 112 at 209.

<sup>115</sup> *Supra.* fn. 83.

<sup>116</sup> *Supra.* fn. 112 at 209.

During Schutz JA's judgement he also specifically stated that he had reached his conclusion without reference to section 20(2A)(b). The following extract of Schutz JA's judgement contains his mention of section 20(2A)(b):<sup>117</sup>

*"I have reached this conclusion without reference to s 20 (2A)(b), introduced in 1973, the effect of which is that in the case of a taxpayer other than a company, he may carry forward an assessed loss even though he has not derived any income from trade during a particular year. If this subsection may be taken into account in construing subsection(1) it can only make Robin's burden of persuasion more difficult." (own emphasis)*

#### 4.8.2 Relevant commentary and analysis

This case confirmed the judgment of *New Urban Properties (Pty) Ltd v SIR*<sup>118</sup> in which a continuity of trading between the incurring of the assessed loss and the carrying forward thereof into the following year of assessment is envisaged. Accordingly, a new balance has to be struck at the end of each year of assessment and carried forward to the following year of assessment, until it is exhausted. The result of the aforementioned is that the assessed loss disappears in a year in which there is no income or loss from trading (i.e. where the continuity of trading has been interrupted).<sup>119</sup> Conversely, in order to carry forward an assessed loss from the previous year of assessment, the taxpayer had to have conducted a trade during the current year of assessment for which an assessment had been issued.<sup>120</sup> In this regard a trading loss incurred during a subsequent year of assessment would not result in a taxpayer forfeiting its balance of assessed loss. The reason is that such a trading loss would necessitate the issue of an assessment to the taxpayer, and accordingly, a new balance is struck at the end of that year of assessment.<sup>121</sup>

As discussed in Chapter 4.2.2, Ngalwana explained the semantic meaning of the term 'set off' as contemplated in section 20(1) and concluded that the term envisages two opposites (i.e. a positive figure that is set off against a negative figure).<sup>122</sup> However, the requirement to strike a new balance at the end of a year of assessment effectively overlooks the semantic meaning of the term 'set off' and could therefore effectively result in the addition of a trading loss incurred during a subsequent year of assessment to a balance of assessed loss brought forward from the preceding year of assessment.<sup>123</sup>

The Court's judgement in this case only considered the 'trade' requirement, as the assessed loss was disallowed on the basis that there were no trading activities conducted by the taxpayer during its 1988 year of assessment. With regards to the 'income' requirement, it is worth noting that, although Schutz JA made reference to section 20(2A)(b), he specifically stated that he had reached his conclusion without reference to that section (i.e. his decision was solely based on the 'trade' requirement). Accordingly, the decision in this case does not provide for the basis that section 20(2A)(b) must be taken into account in construing whether section 20(1) allows for a company to carry forward any balance of assessed loss from the preceding year of assessment, even though it had derived no income from trading during the current year of assessment. Based on the aforementioned, it would be appropriate to conclude that this Court's judgement does not include a discussion on the 'income' requirement (i.e. whether the carry forward of an assessed

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<sup>117</sup> Ibid at 210.

<sup>118</sup> Supra. fn. 83.

<sup>119</sup> Supra. fn. 103 at 329.

<sup>120</sup> Supra. fn. 3 at 391.

<sup>121</sup> Ibid at 392.

<sup>122</sup> Supra. fn. 12 at 203.

<sup>123</sup> Supra. fn. 3 at 392.

loss would be allowed in the event where the taxpayer had traded, but derived no income therefrom).

## **4.9 Income Tax Case No 1679**

### 4.9.1 Judgement

In *ITC 1679*,<sup>124</sup> which was delivered on 16 September 1996 in the Orange Free State Special Court, the taxpayer company had an assessed loss at the end of its 1994 year of assessment. The taxpayer initially traded as a shop, but during its 1994 year of assessment it converted the business to that of a tourism consultancy business. During its 1995 year of assessment the taxpayer derived no income, but incurred certain expenditure in respect of new letterheads, business cards, brochures and other pamphlets, the production of a video and tapes for the American market, and a promotion trip to America in order to recruit clients for its tourism consultancy business. The issue before the Court was, among others, whether the taxpayer was allowed to carry forward its balance of assessed loss determined at the end of its 1994 year of assessment to its 1995 year of assessment.

The taxpayer contended that it was only required to show that it had conducted a trade during its 1995 year of assessment in order to carry forward its balance of assessed loss determined at the end of its 1994 year of assessment (i.e. the 'trade' requirement). The Commissioner contended that, in order to carry forward its assessed loss to its 1995 year of assessment, it had to prove that it had traded and had generated income during its 1995 year of assessment (i.e. the 'income' requirement).

For the purposes of the judgement, the Court assumed that the taxpayer had carried on a trade during its 1995 year of assessment. During Musi J's judgment, he expressed the view that the 'income' requirement was discussed fully and, in his view, settled by the Supreme Court of Appeal in the matter between *Robin Consolidated Industries Ltd v CIR*.<sup>125,126</sup> In this regard he concluded that a company must have derived some 'income from trade' during the current year of assessment in order to carry forward its balance of assessed loss from the preceding year of assessment to the current year of assessment. Musi J further explained that, where there is no income during its 1995 year of assessment, there would be nothing against which to set off and balance its assessed loss from the previous year of assessment, which would therefore result in the essential continuity being interrupted (i.e. the continuity in setting off an assessed loss). In this regard the Court, per Musi J, stated that income was therefore the essential link in this chain and without it (i.e. income) the chain is considered to be broken. The taxpayer therefore had to meet this requirement by deriving at least some income from its trade during its 1995 year of assessment in order to carry forward its assessed loss from its 1994 year of assessment. The Court found that, as the taxpayer had not derived any trading income during its 1995 year of assessment, it was not allowed to carry forward its balance of assessed loss determined at the end of its 1994 year of assessment.

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<sup>124</sup> *ITC 1679* (1999) 62 SATC 294 (O).

<sup>125</sup> *Supra*. fn. 112.

<sup>126</sup> This view has been contested and is discussed further in Chapter 4.9.2 under the 'Relevant commentary and analysis' section.

#### 4.9.2 Relevant commentary and analysis

According to Swart,<sup>127</sup> the Court's conclusion that the requirement to derive income from its trade in order to carry forward a company's assessed loss was clearly based on an analysis of the judgements in *Robin Consolidated Industries Ltd v CIR*<sup>128</sup> and *New Urban Properties (Pty) Ltd v SIR*.<sup>129</sup> Swart further raises the question whether the conclusion reached in *ITC 1679*<sup>130</sup> is justifiable in the light of the aforementioned cases.<sup>131</sup> According to Swart, these judgements are, to say the least, inconclusive in relation to the requirement that the derivation of income is a prerequisite for a company to carry forward its balance of assessed loss from the preceding year of assessment.<sup>132</sup> Swart does, however, state thereafter that some authors do support the view that the derivation of income is a prerequisite for a company to preserve its balance of assessed loss.<sup>133,134</sup>

As discussed in Chapter 4.8, the Court's judgement in *Robin Consolidated Industries Ltd v CIR*<sup>135</sup> only considered the 'trade' requirement and did not at all consider whether the derivation of income is a prerequisite for a company to be allowed to carry forward its balance of assessed loss from the preceding year of assessment. This was later confirmed in *CSARS v Megs Investments (Pty) Ltd and Another*<sup>136</sup> where Jones AJA specifically emphasised that, in *Robin Consolidated Industries Ltd v CIR*<sup>137</sup> the Court did not decide on the question left open in *SA Bazaars (Pty) Ltd v CIR*<sup>138</sup> (i.e. the 'income' requirement). The Court's judgement in *New Urban Properties (Pty) Ltd v SIR*,<sup>139</sup> which is discussed in Chapter 4.6, explained that the machinery of setting off an assessed loss cannot operate if there is no income or loss from trading during a specific year of assessment. In this regard the Court's judgement in *New Urban Properties (Pty) Ltd v SIR*<sup>140</sup> did not consider whether income is a prerequisite for a company to carry forward its balance of assessed loss from the preceding year of assessment (i.e. the 'income' requirement) at all. As a result, the Court in *ITC 1679*<sup>141</sup> held that the derivation of income is a prerequisite for a company to carry forward its balance of assessed from the preceding year of assessment, but relied on decisions that pointed to the requirement of continuity in regard to the carrying on of a trade rather than the derivation of income.<sup>142</sup>

In this case the Court assumed that the taxpayer had carried on a trade during its 1996 year of assessment and therefore did not include a discussion of the 'trade' requirement, but based on this assumption it had accepted that this requirement had been met. The judgement included a discussion on the 'income' requirement, but as discussed in this commentary and analysis section, it based its decision on judgements that pointed to the requirement of continuity regarding the carrying on of a trade rather than the derivation of income. In this regard and in my opinion, the reliance on this case on the existence of the 'income' requirement is questionable.

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<sup>127</sup> Supra. fn. 8 at 456.

<sup>128</sup> Supra. fn. 112.

<sup>129</sup> Supra. fn. 83.

<sup>130</sup> Supra. fn. 124.

<sup>131</sup> Supra. fn. 8 at 456.

<sup>132</sup> Ibid.

<sup>133</sup> Ibid at 458.

<sup>134</sup> The authors mentioned by Swart were: E Spiro 'Income Tax -Deductions- Whether Balance of Assessed Loss Prior to Non-Trading Period Thereafter Deductible' (1952) 1 The Taxpayer 213 at 214) and Isaac Isaacs, L Lazer, WD Fielding & Maurice Johnson Wells Law and Practice of South African Income Tax (1963) in par 500.

<sup>135</sup> Supra. fn. 112.

<sup>136</sup> *CSARS v Megs Investments (Pty) Ltd and Another* 2005 (4) SA 328 (SCA), 66 SATC 175 at 6.

<sup>137</sup> Supra. fn. 112.

<sup>138</sup> Supra. fn. 63.

<sup>139</sup> Supra. fn. 83.

<sup>140</sup> Ibid.

<sup>141</sup> Supra. fn. 124.

<sup>142</sup> Supra. fn. 8 at 457.

## 4.10 CSARS v Megs Investments (Pty) Ltd and Another

### 4.10.1 Judgement

In *CSARS v Megs Investments (Pty) Ltd and Another*,<sup>143</sup> which was delivered on 31 March 2004 in the Supreme Court of Appeal, the taxpayer companies traded at a profit during their 1995 year of assessment. The companies had accumulated substantial assessed losses during the previous years of assessment, which was brought forward and set off against the income derived from trading during that year of assessment. The trading activities of the taxpayers consisted of arranging and managing discounts for their members (which consisted of various wholesale and retail supermarket and grocery outlets) from various suppliers, by using the combined buying power of its members. The taxpayers' profit consisted of the difference between the discounts that they received from the suppliers and the discounts that they passed on to their members. On the first day of their 1996 year of assessment, the taxpayers sold their entire businesses as a going concern to Shoprite Checkers (Pty) Ltd ("Shoprite"). In this regard the taxpayers still had certain obligations during the transition period (which formed part of their 1996 year of assessment), but did not carry on their normal trade of recovering a portion of the discounts received for their own account during their 1996 year of assessment. During their 1996 year of assessment the taxpayers received interest on the purchase price during the time that it was held in a trust and pending payment thereof to them until they had fulfilled certain conditions. A portion of the proceeds was thereafter invested in an Absa call account with another portion being invested free of interest in three Namibian companies. The remainder thereof was distributed as a dividend.

It was common knowledge that the taxpayers' investments in the Namibian companies were made with a view of possibly developing a similar businesses in Angola and other countries to the north (i.e. similar to the businesses sold to Shoprite) through and with the Namibian companies. It was also accepted that they also sought to exploit wholesale liquor and firearm licences which had not been previously sold to Shoprite. The taxpayers' directors spent considerable money, time and effort during their 1996 year of assessment on these activities, but no contracts were concluded, no organisation was established, no active trading was done and no income was earned. The issue before the Court was whether the taxpayers were allowed to set off the interest earned during their 1996 year of assessment against the balance of assessed loss determined at the end of their 1995 year of assessment.

The taxpayers had contended that they were allowed to set off the interest earned during their 1996 year of assessment against the balance of assessed loss determined at the end of their 1995 year of assessment. The Commissioner had contended that the taxpayers were not entitled in terms of the Act to set off the interest income earned during the 1996 year of assessment against their balance of assessed loss determined at the end of the 1995 year of assessment, on the basis that they did not carry on a trade and also did not generate any income from that trade during their 1996 year of assessment.

As part of the judgement the Court accepted that the activities undertaken by the taxpayers during their 1996 year of assessment constituted trading. However, during the course of the hearing it was conceded by counsel for the taxpayers that, in order for set off to be allowed, they had to show "*a connection between the trade they carried on and the income they received*" (i.e. counsel for the taxpayers effectively conceded that an 'income' requirement exists and that they had to satisfy this requirement in order to succeed).<sup>144</sup> The Court held (based on the concession)

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<sup>143</sup> Supra. fn. 136.

<sup>144</sup> Ibid at 9.

that the taxpayers had not carried on the trade of an investment company and therefore the interest income earned during the 1996 year of assessment did not constitute income earned from the carrying on of a trade. As a result, the taxpayers had failed to show the connection between the interest income earned during their 1996 year of assessment and the trade that they had carried on during that year of assessment (as per their concession). Accordingly, the taxpayers were not allowed to set off the interest income earned during their 1996 year of assessment against the balance of assessed loss determined at the end of their 1995 year of assessment.

During Jones AJA's judgement, he specifically emphasised that the decision in *Robin Consolidated Industries Ltd v CIR*<sup>145</sup> did not decide on the question left open in *SA Bazaars (Pty) Ltd v CIR*<sup>146</sup> (i.e. the 'income' requirement). In this regard the following extract of Jones AJA's judgement is deemed relevant for the purpose of this study:<sup>147</sup>

*"It is important to emphasise that in Robin Consolidated Industries Ltd this court did not decide the question left open in the SA Bazaars case. Schutz JA distilled the two propositions just quoted from the ratio of that case. It is in this context that the statement at 666G-667A must be understood."* (own emphasis and footnotes omitted)

The following extract of Jones AJA's judgement is also deemed relevant for the purpose of this study as it relates to a remark made by Jones AJA in respect of the concession made by the taxpayers (which essentially deals with the primary research question to this study, i.e. the 'income' requirement):<sup>148</sup>

*"I think that in the light of the wording of s 20(1) and the wording of s 11(a) of the Act as it then read the concession may have been correctly made. I prefer, however, to say no more on the point. I must make it clear that no argument to the contrary has been placed before us, the point has not been given the consideration which contrary argument would require, and my decision is based on the concession."* (own emphasis and footnotes omitted)

#### 4.10.2 Relevant commentary and analysis

An important starting point to this case is that the Court referred to its earlier decision in *Robin Consolidated Industries Ltd v CIR*<sup>149</sup> and held that it could not serve as authority for the view that the derivation of income is a prerequisite for a company to be allowed to carry forward its balance of assessed loss from the preceding year of assessment, as the judge in that case did not unequivocally hold that income was required for an assessed loss to be carried forward.<sup>150</sup>

In this case the decision of the Court was based on the concession made by counsel for the taxpayers (i.e. they had to show a connection between the trade carried on and the income they received). In this regard Emslie and Davis remark that it is important to note that the Court refrained from making any finding on the 'income' requirement (i.e. whether the carry forward of an assessed loss would be allowed in the event where the taxpayer had traded, but derived no income therefrom).<sup>151</sup> In discussing this case, Williams RC remarks that it is clear that section 20(1) contains a 'trade' requirement, but that it is not clear whether it is a requirement for such a trade to have produced income (i.e. the 'income' requirement). Williams RC further remarks that counsel for the taxpayers had made the concession with SARS for reasons unknown, but

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<sup>145</sup> Supra. fn. 112.

<sup>146</sup> Supra. fn. 63.

<sup>147</sup> Supra. fn. 136.

<sup>148</sup> Ibid at 9.

<sup>149</sup> Supra. fn. 112.

<sup>150</sup> Supra. fn. 103 at 329.

<sup>151</sup> Supra. fn. 106 at 826.

speculates that counsel for the taxpayers may have known that they could prove that the companies had derived income in the form of interest and considered this concession to be safe. In this regard Williams RC concludes that the decision in this case is not authority for the proposition that an 'income' requirement exists as the Court did not pronounce upon the correctness of the 'income' requirement, but based its decision on counsel's concession.<sup>152</sup> The judgement in this case did not make a finding of law in relation to the 'income' requirement, and therefore its decision in this regard does not amount to the establishment of legal precedent in relation to the 'income' requirement.<sup>153</sup> It should also be noted that, where Jones AJA mentioned that the concession may have been correctly made (refer to the second extract of Jones AJA's judgement above), he actually referred to the different conclusions reached by the Tax Courts in relation to this matter in terms of a footnote. In this regard he referred to *ITC 1679*<sup>154</sup>, *ITC 664*<sup>155</sup> and *ITC 777*.<sup>156</sup>

The Court's judgement in this case included a discussion on the 'trade' requirement and certain aspects of the 'income' requirement (i.e. based on the concession). In regard to the 'trade' requirement, the Court accepted that the activities undertaken by the taxpayers constituted trading, but as a result of the concession made by counsel for the taxpayers, the Court had to determine whether the interest income earned during the current year of assessment had a connection with the trade carried on during the current year of assessment. Based on the concession and without making a finding as to whether section 20(1) contains an 'income' requirement, the Court held that the taxpayers were unable to show the connection between the income earned and the trade carried on by the taxpayers. The Court, however, based its decision on the concession made by counsel for the taxpayers and therefore refrained from making a finding on the 'income' requirement. In this regard this case does not serve as authority for the existence of an 'income' requirement.

## **4.11 Income Tax Case No 1830**

### **4.11.1 Judgement**

In *ITC 1830*,<sup>157</sup> which was delivered on 5 October 2007 in the Gauteng Tax Court, the taxpayer company had carried on the business of awarding licences to the security industry for the use of its internally developed computer programme. As a result of the development expenditure incurred by the taxpayer, it had determined a balance of assessed loss at the end of its 2003 year of assessment. During the taxpayer's 2004 year of assessment it had incurred a further loss and the only income earned by the taxpayer during that year of assessment consisted of some interest income and other small amounts of sundry income. It was, however, conceded by the taxpayer that the aforementioned income was unrelated to the taxpayer's trading activities. The issue before the Court was whether the taxpayer was allowed to carry forward its balance of assessed loss from the preceding year of assessment even though it had derived no income from trading during the current year of assessment.

The taxpayer had contended, among other things, that the receipt or accrual of income is not a prerequisite for a company to be allowed to carry forward its balance of assessed loss determined

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<sup>152</sup> Supra. fn. 88 at 532.

<sup>153</sup> Supra. fn. 13 at 8.127.

<sup>154</sup> Supra. fn. 124.

<sup>155</sup> Supra. fn. 49.

<sup>156</sup> Supra. fn. 32.

<sup>157</sup> Supra. fn. 43.

at the end of its 2003 year of assessment, whereas the Commissioner had contended that, in order for the taxpayer to be allowed to carry forward its balance of assessed loss determined at the end of its 2003 year of assessment, it must have traded during its 2004 year of assessment and must have derived income from that trade as well.

For the purposes of the judgement, the Court assumed that the taxpayer had carried on a trade during its 2004 year of assessment. The Court held that income must have been received by or accrued to the taxpayer during its 2004 year of assessment in order for the taxpayer to carry forward its balance of assessed loss determined at the end of its 2003 year of assessment.

The following extract of Gildenhuis J's judgement is deemed relevant for the purpose of this study as it provides the supporting cases on which he had based his decision:<sup>158</sup>

*"Giving the wording of s 20(1) its plain meaning, I cannot but conclude that a balance of assessed loss brought forward to any tax year cannot be set-off if there was no income during that tax year against which to set it off.*

*As I have shown, this conclusion is supported by observations contained in the Conshu and Meggs Investments judgments. Although these observations did not constitute the ratio decidendi in any of them, they remain of significance.*

*Furthermore, it was held in two Income Tax Cases (Case No ITC 664 and Case No ITC 1679, discussed above) that an assessed loss cannot be set off if there is no income against which a balance can be struck." (own emphasis)*

Gildenhuis J further reasoned that it would not be out of place for the existence of an 'income' requirement, as section 20(1) already requires a continuity of trading (i.e. the 'trade' requirement). In this regard he stated the following:<sup>159</sup>

*"I now turn to other considerations which bear on my reading of s 20(1). It is trite law that, unless there is a continuity of trading, no balance of assessed loss can be carried forward from one year to the next. If the essential continuity is interrupted, there can be no set-off and the balance of assessed loss is forfeited. If, despite the anomalies which must follow, the legislature intended in s 20(1) to require a continuity of trading, it would not be incongruous for the legislature to also require through s 20(1) that there must be a continuity of income."*

The following extract of Gildenhuis J's judgement is also deemed relevant for the purpose of this study as it relates to section 20(2A)(b) which essentially provides for a concession for taxpayers other than companies. In this regard he stated the following:<sup>160</sup>

*"The fact that s 20(2A)(b) specifically provides that a taxpayer other than a company shall not be prevented from carrying forward a balance of assessed loss merely because no income has been derived during the particular tax year, is indicative of an intention on the part of the legislature that, in the case of a company, the derivation of income is a requirement for carrying forward a balance of assessed loss." (own emphasis)*

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<sup>158</sup> Ibid at 22.

<sup>159</sup> Ibid at 24.

<sup>160</sup> Ibid at 25.

In regard to the contents of *SARS Interpretation Note 33*,<sup>161</sup> Gildenhuis J also remarked that SARS "cannot (and clearly did not intend to) change the law by making concessions to address unintended results".<sup>162</sup>

#### 4.11.2 Relevant commentary and analysis

In analysing the Court's reasoning in *ITC 1830*<sup>163</sup> Cornelissen submits that a good argument can be made that the Court erred in the application of the authorities quoted and ultimately in the finding of the Court.<sup>164</sup> Cornelissen explains that, during the Court's judgement, Gildenhuis J referred to the majority judgement in *Conshu (Pty) Ltd v CIR*<sup>165</sup> which held that the term 'income' to which an assessed loss is set off against is not used in its defined term, but rather as "income taxable but for the set off of assessed losses".<sup>166</sup> In this regard Cornelissen shares that, in his view, the minority judgement in *Conshu (Pty) Ltd v CIR*<sup>167</sup> represents the accepted approach (i.e. income as defined in section 1(1) of the Act).<sup>168</sup> Cornelissen also submits that the remarks made by Jones AJA in *CSARS v Megs Investments (Pty) Ltd and Another*<sup>169</sup> in relation to the 'income' requirement are nothing more than *obiter* (as it was specifically stated in *CSARS v Megs Investments (Pty) Ltd and Another*<sup>170</sup> that the decision was based on the concession made by counsel for the taxpayer and that no argument had been placed before the Court in that regard).<sup>171</sup>

Olivier submits that the judgement of *ITC 1830*<sup>172</sup> cannot be faulted when she explains that the intention of the legislature is clear by the plain words it used.<sup>173</sup> As a concluding note she adds that it may be time to amend legislation in order to prevent unintended circumstances arising out of such a requirement.<sup>174</sup> In his analysis of *ITC 1830*<sup>175</sup> Silke J remarks that, although SARS cannot change the law by making concessions to address unintended results, the literal interpretation of section 20(1) is also not a solution.<sup>176</sup> In this regard Silke J concludes that a decision from a superior court in relation to this matter would now be required in order to depart from a literal interpretation of the section.<sup>177</sup> In Haupt's discussion of *ITC 1830*<sup>178</sup> he remarks that the decision of the Court is clearly an inequitable result and could not have been what the legislature had intended in terms of the relevant provisions pertaining to the carrying forward of assessed losses.<sup>179</sup> He then concludes by stating that the judgement of a Tax Court (such as in *ITC 1830*)<sup>180</sup> does not create legal precedent and that it is hoped that either a superior court makes a firm pronouncement on the principle, or that the law be clarified in this regard.<sup>181</sup>

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<sup>161</sup> Supra. fn. 9.

<sup>162</sup> Supra. fn. 43 at 27.

<sup>163</sup> Ibid.

<sup>164</sup> Cornelissen, C. "Assessed Losses: The Gauteng Tax Court Confirms the Income-from-Trade Requirement." De Rebus 2008, no. 479 (September, 2008): 52 - 54.

<sup>165</sup> Supra. fn. 27.

<sup>166</sup> Ibid.

<sup>167</sup> Ibid.

<sup>168</sup> Supra. fn. 164.

<sup>169</sup> Supra. fn. 136.

<sup>170</sup> Ibid.

<sup>171</sup> Supra. fn. 164.

<sup>172</sup> Supra. fn. 43.

<sup>173</sup> Supra. fn. 103 at 330.

<sup>174</sup> Ibid.

<sup>175</sup> Supra. fn. 43.

<sup>176</sup> Silke, J. "Assessed Losses." Tax Planning Corporate and Personal 22, no 5 (October, 2009).

<sup>177</sup> Ibid.

<sup>178</sup> Supra. fn. 43.

<sup>179</sup> Haupt, P. "Assessed Losses." Chap. 11, In *Notes on South African Income Tax*. Vol Thirty-Eighth Edition, 291, 2019.

<sup>180</sup> Supra. fn. 43.

<sup>181</sup> Supra. fn. 179.

Emslie and Davis also seems to find it difficult to find fault with the judgement of *ITC 1830*<sup>182</sup> due to the fact that section 20(2A)(b) specifically provides for a concession to taxpayers other than companies, in which they are not prevented from carrying forward their balance of assessed loss from the preceding year of assessment as a result of not having derived any income during the current year of assessment.<sup>183</sup> In this regard they state that this concession provided to taxpayers other than companies is indicative of an intention on the part of the Legislature that such an 'income' requirement may exist.<sup>184</sup> In their concluding remark they do however, state that it would not be inconceivable for a Court to adopt a purposive interpretation of section 20(1)(a).<sup>185</sup> In commenting on the judgement of *ITC 1830*<sup>186</sup> Meyerowitz remarked that a literal interpretation of section 20(1), in the context of all the relevant provisions pertaining to determining the taxable income, does not only give rise to anomalies, but also results in an absurdity which would in his opinion entitle a Court to depart from the literal meaning of the words.<sup>187</sup>

In my view the Tax Court cases referred to by Gildenhuis J in *ITC 1830*<sup>188</sup>, which held that income is a requirement for a balance to be struck (i.e. the 'income' requirement), should also be analysed further in order to determine whether these cases provide for sufficient support for Gildenhuis J to have based his decision on. In this regard:

- It was held *obiter* in *ITC 664*<sup>189</sup> that an assessed loss could only be carried forward to the subsequent year of assessment where the current year's trade gave rise to income (refer to discussion in Chapter 4.2.2);
- The decision in *ITC 1679*<sup>190</sup> held that the derivation of income is a prerequisite for a company to carry forward its balance of assessed loss from the preceding year of assessment, but relied on decisions that all pointed to the requirement of continuity in regard to the carrying on of a trade rather than the derivation of income (refer to discussion in Chapter 4.9.2); and
- In my view it is thus doubtful whether these two cases could be regarded as providing sufficient support for Gildenhuis J to have based his decision on in regard to the existence of an 'income' requirement.

In considering the relevant commentary on *ITC 1830*<sup>191</sup> it is clear that the majority of the commentators agree that, based on the literal interpretation of the wording contained in section 20, they are unable to find fault with its decision.

In this case the Court assumed that the taxpayer had carried on a trade and therefore did not include a discussion of the 'trade' requirement, but based on this assumption it accepted that this requirement had been met. The Court's judgement consisted of a discussion of the 'income' requirement and held, based on the observations made by two superior court cases (i.e. *Conshu*

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<sup>182</sup> Supra. fn. 43.

<sup>183</sup> Supra. fn. 106 at 833.

<sup>184</sup> Ibid.

<sup>185</sup> Ibid.

<sup>186</sup> Supra. fn. 43.

<sup>187</sup> Meyerowitz, D. *The Taxpayer* 2008: 93-5.

<sup>188</sup> Supra. fn. 43.

<sup>189</sup> Supra. fn. 49.

<sup>190</sup> Supra. fn. 124.

<sup>191</sup> Supra. fn. 43.

(Pty) Ltd v CIR<sup>192</sup> and CSARS v Megs Investments (Pty) Ltd and Another),<sup>193</sup> the judgements of two income tax cases (i.e. ITC 664<sup>194</sup> and ITC 1679)<sup>195</sup> and the existence of the concession provided to taxpayers other than companies in terms of section 20(2A)(b), that the derivation of income is a requirement in order for a company to be allowed to carry forward its balance of assessed loss from the preceding year of assessment. In this regard it should be noted that the Tax Court is not a court of law and has no inherent jurisdiction. Accordingly, the decision of the Tax Court does not constitute a precedent which binds itself, any superior court or the Commissioner.<sup>196</sup>

#### 4.12 Conclusion

Based on the relevant views analysed in our courts in the context of section 20(1) there have been two Tax Court decisions (i.e. ITC 1679<sup>197</sup> and ITC 1830<sup>198</sup>) which contained the *ratio decidendi* that an 'income' requirement exists and as a result thereof the taxpayers in those judgements were unsuccessful in carrying forward their balance of assessed loss determined at the end of their preceding year of assessment. Furthermore, there are two Supreme Court of Appeal decisions that have mentioned the possible existence of an 'income' requirement (i.e. *Conshu (Pty) Ltd v CIR*<sup>199</sup> and *CSARS v Megs Investments (Pty) Ltd and Another*),<sup>200</sup> but these views are submitted to be mere *obiter*.

As pointed out in the judgement of *ITC 1830*,<sup>201</sup> the mere existence of section 20(2A)(b), which provides a concession for taxpayers other than companies, that they would not be prevented from carrying forward their balance of assessed loss merely because they had not derived any income during the current year of assessment, is also indicative that an 'income' requirement may exist.

On this issue the judgement of *Robin Consolidated Industries Ltd v CIR*<sup>202</sup> specifically refrained from answering whether section 20(2A)(b) should be taken into account in construing section 20(1), but mentioned that, if that may be the case, it could make the burden of proof much more difficult for a company which seeks to carry forward its balance of assessed loss determined at the end of its previous year of assessment without having derived any income during the current year of assessment. However, to date a Superior Court has not held that section 20(2A)(b) should be taken into account in construing section 20(1) and would, in my view, require confirmation from our Superior Courts that this would indeed be the case.

What is clear from the views analysed is the methodology for establishing a balance of assessed loss. This methodology was first described in *CIR v Louis Zinn Organization (Pty) Ltd*<sup>203</sup> in which it envisaged the accumulation of assessed losses (i.e. the current year's assessed loss is added to the balance of assessed loss determined at the end of the previous year of assessment in order to determine a new and larger balance of assessed loss). In the judgement of *New Urban*

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<sup>192</sup> Supra. fn. 27.

<sup>193</sup> Supra. fn. 136.

<sup>194</sup> Supra. fn. 49.

<sup>195</sup> Supra. fn. 124.

<sup>196</sup> Supra. fn. 13 at 8.127.

<sup>197</sup> Supra. fn. 124.

<sup>198</sup> Supra. fn. 43.

<sup>199</sup> Supra. fn. 27.

<sup>200</sup> Supra. fn. 136.

<sup>201</sup> Supra. fn. 43.

<sup>202</sup> Supra. fn. 112.

<sup>203</sup> Supra. fn. 71.

*Properties (Pty) Ltd v SIR*<sup>204</sup> this methodology was taken further when confirming that section 20(1) requires a continuity of trading between the incurring of the assessed loss and the carrying forward thereof to the following year of assessment. In this regard the Court held that a balance is struck at the end of each year of assessment, which is then carried forward to the following year of assessment, until it is exhausted. The Court's judgement also explained that, where there is no income or loss from trading in a particular year, it would result in no balance being struck for that year of assessment (i.e. resulting in the taxpayer forfeiting its balance of assessed loss). In the judgement of *Robin Consolidated Industries Ltd v CIR*<sup>205</sup> it confirmed the judgement of *New Urban Properties (Pty) Ltd v SIR*<sup>206</sup> and clarified that a balance of assessed loss can only be carried forward to the following year of assessment if the taxpayer had conducted a trade during the current year of assessment for which an assessment had been issued. In this regard an assessment is issued as a result of its trading activities (i.e. reflecting an income or loss from trading).

All of the decisions discussed in this chapter were, however, held prior to the decision of *Natal Joint Municipal Pension Fund v Endumeni Municipality*<sup>207</sup> which essentially settled the current approach to the interpretation of statutes (as discussed in Chapter 2.3). The following chapter therefore applies the principles laid down in *Natal Joint Municipal Pension Fund v Endumeni Municipality*<sup>208</sup> in interpreting whether section 20(1) allows for a company to carry forward its balance of assessed loss determined at the end of its previous year of assessment to its current year of assessment, in circumstances where it derived no 'income' from its trading activities during the current year of assessment.

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<sup>204</sup> Supra. fn. 83.

<sup>205</sup> Supra. fn. 112.

<sup>206</sup> Supra. fn. 83.

<sup>207</sup> Supra. fn. 14.

<sup>208</sup> Ibid.

## **CHAPTER 5: THE INTERPRETATION OF SECTION 20(1) BASED ON THE PRINCIPLES LAID DOWN IN NATAL JOINT MUNICIPAL PENSION FUND V ENDUMENI MUNICIPALITY**

### **5.1 Introduction**

The current approach to the statutory interpretation in our courts was settled in the decision of the Supreme Court of Appeal in *Natal Joint Municipal Pension Fund v Endumeni Municipality*,<sup>209</sup> whereas all of the decisions discussed in Chapter 4 were held prior to this decision. The purpose of this chapter, therefore, is to apply the principles laid down in *Natal Joint Municipal Pension Fund v Endumeni Municipality*<sup>210</sup> to the question of whether a company would be allowed to carry forward its balance of assessed loss determined at the end of its previous year of assessment to its current year of assessment in circumstances where it derived no 'income' from its trading activities during the current year of assessment.

### **5.2 Applying the Endumeni principles**

As discussed in Chapter 2.3, the current approach to the interpretation of statutes should be based on the wording of the section which should be considered in the light of the context in which it appears, and should consider the apparent purpose to which it is directed at as well as the relevant background material known to the drafters of the relevant provision.

#### 5.2.1 Wording of section 20(1)

Using a literal interpretation of the wording of section 20(1) and by giving the wording its plain meaning as it stands, it would be difficult to conclude that a company would be allowed to carry forward its balance of assessed loss from the preceding year of assessment in the event where there is no income which is available to set off against the balance brought forward. Furthermore, when considering the semantic meaning of the word 'set off', one would find it difficult to interpret it to mean that a negative amount (i.e. a loss in the current year) is set off against another negative amount (i.e. the balance of assessed loss brought forward from the preceding year of assessment).

#### 5.2.2 Context of section 20(1)

In my view it is clear that section 20(1) accommodates taxpayers for the artificial result that is created due to determining a taxpayer's activities in a single year of assessment.<sup>211</sup> In this regard section 20(1) envisages circumstances in which a taxpayer could be in a trading loss position during any year of assessment, which essentially provides for the context in which section 20(1) should be considered.

Furthermore, in terms of the judgment of *Telkom SA SOC Ltd v CSARS*<sup>212</sup> the relevant context of a section (such as section 20(1)) should be determined independent of the factual circumstances of the relevant scenario, which essentially means, for example, that the context is determined based on the wording of the section and not whether the trading loss occurred as a result of circumstances contemplated in either the First Scenario (i.e. deductible expenditure which

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<sup>209</sup> Ibid.

<sup>210</sup> Ibid.

<sup>211</sup> Supra. fn. 3.

<sup>212</sup> Supra. fn. 17.

exceeds income) or the Second Scenario (i.e. deductible expenditure with no corresponding income in the same year of assessment).

However, it should also be noted that section 20(1) falls within section 20 which contains section 20(2A)(b). Therefore, in the light of section 20(2A)(b) also appearing within section 20, this provides an indication that an 'income' requirement may exist (refer to the discussion in Chapter 5.2.4 in this regard).

### 5.2.3 Purpose of section 20(1)

The purpose of the section is clearly to enable taxpayers to utilise the assessed losses made during previous years of assessments in future years of assessment (which essentially is necessary as a result of determining the taxpayer's activities in only a single year of assessment).

### 5.2.4 Relevant background material known to the drafters of the relevant provision

Section 20(2A) was inserted into section 20 in terms of section 15(1) of the Income Tax Act, No. 65 of 1973. It was thereafter amended in terms of section 19(e) of the Taxation Laws Amendment Act, No. 8 of 2007 and then again in terms of section 39(c) of the Taxation Laws Amendment Act, No. 15 of 2016. The subsequent amendments contained no significant changes to section 20(2A), but are discussed for the sake of completeness.

The amendment in terms of section 19(e) of the Taxation Laws Amendment Act, No. 8 of 2007 was merely in order to delete the words "*in the Republic*" which was then still contained in section 20(2A)(a). The amendment to section 20(2A)(a) thus followed a similar amendment to section 20(1) as a result of the introduction of worldwide taxation in South Africa.<sup>213</sup> Thereafter, section 39(c) of the Taxation Laws Amendment Act, No. 15 of 2016 replaced the word "taxpayer" in section 20(2A) with the word "person" as a matter of style consistency.<sup>214</sup> Other than for the aforementioned amendments to section 20(2A), the wording inserted in terms of section 15(1) of the Income Tax Act, No. 65 of 1973, is quite similar to the current wording contained in the Act.<sup>215</sup>

Clause 15 of the Explanatory Memorandum on the Income Tax Bill, 1973<sup>216</sup> provided the following explanation as to the reasoning behind the insertion of section 20(2A):

*"The amendment gives effect to a recommendation of the Commission of Enquiry into Fiscal and Monetary Policy in South Africa, that a person other than a company should not be deprived of the benefit of setting off against income any assessed loss incurred by him."*  
(own emphasis)

The recommendation referred to in clause 15 of the Explanatory Memorandum on the Income Tax Bill, 1973<sup>217</sup> was, in fact, a recommendation included in terms of the Second Report of the Commission of Enquiry into Fiscal and Monetary Policy in South Africa ("the Commission").<sup>218</sup> This

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<sup>213</sup> Explanatory Memorandum on the Taxation Laws Amendment Bill, 2007, clause 19(e). Available: <https://www.sars.gov.za/AllDocs/LegalDoclib/ExplMemo/LAPD-LPrep-EM-2007-05%20-%20Explanatory%20Memorandum%20Taxation%20Laws%20Amendment%20Bill%202007.pdf> [2020, August 8]

<sup>214</sup> Explanatory Memorandum on the Taxation Laws Amendment Bill, 2016, clause 39. Available: <https://www.sars.gov.za/AllDocs/LegalDoclib/ExplMemo/LAPD-LPrep-EM-2016-02%20-%20EM%20on%20the%20Taxation%20Laws%20Amendment%20Bill%2017B%20of%202016%2015%20December%202016.pdf> [2020, August 8]

<sup>215</sup> Supra. fn. 1.

<sup>216</sup> Explanatory Memorandum on the Income Tax Bill, 1973, clause 15. Available: <https://osall.org.za/docs/2011/02/1973-IT-Bill.pdf> [2020, August 8]

<sup>217</sup> Ibid.

<sup>218</sup> Taxation in South Africa: *Second Report of the Commission of Enquiry into Fiscal and Monetary Policy in South Africa*, November 1970 RP 86/1970: 44-48.

report highlighted the fact that a taxpayer that ceases to carry on trading loses its right to carry forward its balance of assessed loss. The Commission also referred to *ITC 664*<sup>219</sup> and *ITC 777*<sup>220</sup> in mentioning that there are conflicting decisions as to whether the derivation of income is a prerequisite for a taxpayer to carry forward its balance of assessed loss from the preceding year of assessment. In this regard the Commission also pointed out that the aforementioned decisions have no binding authority.<sup>221</sup>

The following extract of the Commission's report is deemed relevant for the purpose of this study:<sup>222</sup>

*"In representations made to the Commission it was requested that the Act should be amended so that the prohibition on the transfer of the balance of assessed loss if a taxpayer has not carried on a trade in a specific year be removed and that non-trading income should also be taken into account in the determining of an assessed loss*

*The Commission has come to the conclusion that the prohibition on the transfer of an assessed loss if a taxpayer has not carried on a trade in a specific year may have unfair circumstances. The Commission is, however, aware that removal of this prohibition in respect of companies may lead to tax avoidance. In respect of individuals, however, there is no danger of this, and the Commission recommends that the Act should be amended so that the balance of an assessed loss sustained by an individual need not fall away if he has not carried on a trade in any specific year.*

*The Commission is also of the opinion that it is equitable to take non-trading income into account in the determining of an assessed loss and recommends that the words "from carrying on any trade" in section 20(1) should be deleted." (own emphasis)*

In comparing the above extract of the Commission's report<sup>223</sup> with the Explanatory Memorandum on the Income Tax Bill, 1973<sup>224</sup> it is important to note that the Commission's report<sup>225</sup> only refers to an individual and a company, whereas the Explanatory Memorandum on the Income Tax Bill, 1973,<sup>226</sup> amended the recommendation made by the Commission by replacing the word 'individual' with 'a person other than a company'. The latter is much broader and includes for example trusts, whereas the former only refers to a natural person.

Furthermore, the only considerations made by the Commission was that the balance of assessed loss of an individual should not be lost as a result of such an individual not carrying on a trade during any specific year, and that non-trading income should be allowed to be taken into account in determining an assessed loss. The only reference made to the possible existence of an 'income' requirement was the reference to the conflicting decisions of *ITC 664*<sup>227</sup> and *ITC 777*.<sup>228</sup> No recommendation was made by the Commission in this regard and the possibility of the 'income' requirement was not discussed in the Commission's report. In my view, the recommendations provided by the Commission is reflected in the wording of section 20(2A)(a).

The inclusion of section 20(2A)(b) clearly then was not as a result of the recommendations made by the Commission. In my view it could be argued that section 20(2A)(b) was included to allow

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<sup>219</sup> Supra. fn. 49.

<sup>220</sup> Supra. fn. 32.

<sup>221</sup> Supra. fn. 218.

<sup>222</sup> Ibid.

<sup>223</sup> Ibid.

<sup>224</sup> Supra. fn. 216.

<sup>225</sup> Supra. fn. 218.

<sup>226</sup> Supra. fn. 216.

<sup>227</sup> Supra. fn. 49.

<sup>228</sup> Supra. fn. 32.

beyond a doubt that individuals (although included in the Act as 'taxpayers other than companies') may be allowed to carry forward their balance of assessed loss in any year of assessment even where they had not derived any income. This would however, in my view, not explicitly mean that a company which does not derive any income would forfeit its right to carry forward its balance of assessed loss.

In considering the Explanatory Memorandum on the Income Tax Bill, 1973<sup>229</sup> and the Commission's report<sup>230</sup> as the relevant background material known to the drafters of the relevant provision, it is submitted that these documents do not support the view that a company which does not derive any income would forfeit its right to carry forward its balance of assessed loss.

### **5.3 Conclusion**

In determining whether a company would be allowed to carry forward its balance of assessed loss determined at the end of its previous year of assessment to the current year of assessment in circumstances where it derived no 'income' from its trading activities during the current year of assessment would require consideration of the wording of section 20(1), the context in which it appears, the apparent purpose to which it is directed at and the relevant background material known to the drafters of the relevant provision.

A literal interpretation of the wording would not allow for a company to carry forward its balance of assessed loss to the current year of assessment, whereas the context in which it appears and its apparent purpose provides otherwise. Furthermore, in terms of the relevant background material known to the drafters of the relevant provision, it is submitted that these documents do not support the view that a company which does not derive any income would forfeit its right to carry forward its balance of assessed loss.

Taking into account the aforementioned principles, it is submitted that the current approach to the interpretation of statutes could have a significant impact as to whether a superior court will decide if a company which does not derive any income would forfeit its right to carry forward its balance of assessed loss.

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<sup>229</sup> Supra. fn. 216.

<sup>230</sup> Supra. fn. 218.

## CHAPTER 6: BUDGET SPEECH – PROPOSED AMENDMENTS

### 6.1 Introduction

Section 20(1) has not been substantially amended for a number of years.<sup>231</sup> However, during the Budget Speech held on 26 February 2020 ("Budget Speech")<sup>232</sup> a few noteworthy amendments were proposed. These proposals were generally designed to broaden the corporate income tax base by restricting the use of assessed losses to a certain extent. These proposals will be discussed in this chapter. The purpose of this chapter is to consider, as a secondary research question, whether the proposals will have any impact on the primary research question of this study.

### 6.2 Proposed amendments

In terms of the Budget Speech, Treasury proposes broadening the corporate income tax base by restricting the offset of assessed losses to 80 per cent of taxable income, for years of assessment starting on or after 1 January 2021.<sup>233</sup> The effective date of this proposal was subsequently postponed to at least 1 January 2022, as a result of the Covid-19 relief measures implemented by Treasury and SARS.<sup>234</sup>

The proposed amendments (if implemented) would result in a company that is in a taxable position (before taking into account its balance of assessed loss carried forward from the preceding year of assessment) being obliged to pay tax on at least 20 per cent of its taxable income, even if its balance of assessed loss would exceed its taxable income for the specific year of assessment.<sup>235</sup> Based on the proposed amendments, it does not seem as if Treasury proposes to amend the 'rules' for carrying forward a balance of assessed loss, but this would only be confirmed once the proposed legislation has been made available.<sup>236</sup>

On the basis that 'rules' for carrying forward a balance of assessed loss are not envisaged to be amended, a company would still need to comply with the provisions of section 20(1) in order to be allowed to carry forward its balance of assessed loss. After successfully being allowed to carry forward its balance of assessed loss during any year of assessment, the limitation rule would then apply to limit the amount of such a balance of assessed loss utilised, to 80 per cent of its taxable income. Where the balance of assessed loss carried forward would exceed 80 per cent of the company's taxable income, the amount to be utilised during a specific year of assessment would be limited to 80 per cent of its taxable income and the company would effectively be taxed at 20 per cent of its taxable income. Conversely, where the balance of assessed loss carried forward would be less than 80 per cent of the company's taxable income, the company should be allowed to utilise its full balance of assessed loss carried forward from the preceding year of assessment.

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<sup>231</sup> The most significant amendments being the removal of the debt benefit provisions contained in section 20 which is now dealt with in section 19 and paragraph 12A of the Eighth Schedule to the Act.

<sup>232</sup> Mboweni, T. (Minister of Finance). "Revenue Trends and Tax Proposals: Limiting the use of Assessed Losses to Reduce Taxable Income." Chap. 4, In *Budget Review 2020*, 42, 26 February 2020.

<sup>233</sup> Ibid.

<sup>234</sup> South African Revenue Service, 'Tax Relief Measures' 6. *Corporate Income Tax*. Available: <https://www.sars.gov.za/Media/Pages/Tax-Relief-measures.aspx> [2020, August 8].

<sup>235</sup> Cliffe Dekker Hofmeyr, 'Restriction on the use of Assessed Losses - Broadening the Corporate Tax Base' *Special Edition Budget Speech Alert 26 February 2020* (2020). Available: <https://www.cliffedekkerhofmeyr.com/en/news/publications/2020/tax/budget-speech-alert-2020-restriction-on-the-use-of-assessed-losses-broadening-the-corporate-tax-base.html> [2020, April 10]

<sup>236</sup> The proposed legislation in terms of the Budget Speech was not yet available at the time of this writing.

### 6.3 Example of proposed amendments

Below is an example of the manner in which the proposed amendments could impact the use of assessed losses for companies. The first column (i.e. Year 1) represents the first year of assessment in which the taxpayer company had determined an assessed loss. The second column (i.e. Current - Year 2) represents the current application of section 20(1), whereas the third column (i.e. Proposed - Year 2) represents the proposed application in respect of the proposed amendments.

<b>Table 1: Proposed amendments example</b>			
	<b>Year 1</b>	<b>Current Year 2</b>	<b>Proposed Year 2</b>
Taxable income/(loss)	-100,000	50,000	50,000
Utilisation of assessed loss	0	-50,000	-40,000
Taxable income after utilisation of assessed loss	0	0	10,000
Tax rate	28%	28%	28%
<b>Tax liability for the year</b>	<b>0</b>	<b>0</b>	<b>2,800</b>
Assessed loss brought forward	0	-100,000	-100,000
Assessed loss carried forward	-100,000	-50,000	-60,000

In terms of the current application of section 20(1) the taxpayer company would not be restricted in utilising its balance of assessed loss carried forward from the preceding year of assessment and would therefore result in a taxable income of nil for its second year of assessment, with a balance of assessed loss of R 50,000 determined at the end thereof. The proposed amendments would, however, result in the taxpayer company being limited in utilising an amount of its balance of assessed loss carried forward from the preceding year of assessment, which is equal to 80 per cent of its taxable income (before taking into account its balance of assessed loss carried forward from the preceding year of assessment). In terms of this example the proposed amendments would therefore result in only R 40,000<sup>237</sup> of its balance of assessed loss carried forward from the preceding year of assessment to be utilised, resulting in the taxpayer company having a taxable income of R 10,000. The taxpayer would therefore incur a tax liability during the second year of assessment, even though it would remain with a balance of assessed loss of R 60,000 at the end of its second year of assessment. The proposed amendments would therefore achieve Treasuries' aim of at least receiving some revenue from affected companies during subsequent years of assessment.

A further scenario could be where a taxpayer company had made a further loss (i.e. trading loss) during its second year of assessment. Where this further loss is as a result of a situation as described in the First Scenario (i.e. deductible expenditure which exceeds income) the taxpayer should, in my view, be unaffected by the proposed amendments as it would in terms of both the current and the proposed amendments not utilise its balance of assessed loss carried forward from the preceding year of assessment, but the further loss would simply increase its balance of assessed loss determined at the end of that year of assessment. The taxpayer's position in terms of the Second Scenario (i.e. deductible expenditure with no corresponding income for the same year of assessment) should not be any different from one in terms of the First Scenario, provided that the taxpayer is not prevented from carrying forward its balance of assessed loss from the preceding year of assessment as a result of having earned no income. In terms of the Second

<sup>237</sup> Calculated as: R 50,000 \* 80%

Scenario, and provided that the taxpayer is allowed to carry forward its balance of assessed loss from the preceding year of assessment, the additional loss incurred during the second year of assessment would merely increase its balance of assessed loss determined at the end of that year of assessment.

#### **6.4 Conclusion**

The amendments proposed in terms of the Budget Speech would seemingly only have an impact on taxpayer companies that are in a taxable position prior to utilising their balance of assessed loss determined at the end of the previous year of assessment, whereas taxpayer companies whose trading activities result in a loss for the current year of assessment should be unaffected.

Based on the above, the amendments proposed in terms of the Budget Speech should not have an impact on the primary research question of this study (although this can only be confirmed once the proposed legislation has been made available in this regard).

## **CHAPTER 7: CONCLUDING REMARKS**

### **7.1 Research question addressed**

The primary research question of this study was whether a company would be allowed to carry forward its balance of assessed loss determined at the end of its previous year of assessment to its current year of assessment even though it had derived no 'income' from its trading activities during the current year of assessment. The secondary research question was whether the recent proposals made by Treasury in terms of the Budget Speech would have an impact on the primary research question.

In order to address the primary and secondary research questions the focus of this study was on the wording of section 20 in light of the guidance on interpreting fiscal statutes, the views expressed in our courts in relation to section 20(1), SARS' guidance in relation to section 20(1), the relevant commentary on the views expressed in our courts in relation to section 20(1) and the recent proposal made by Treasury in relation to assessed losses.

### **7.2 Conclusion of study**

Starting with the latter (i.e. the secondary research question), this study found that, in terms of the recent proposals made by Treasury in terms of the Budget Speech, a company whose trading activities results in a loss for the current year of assessment should be unaffected by the proposed amendments (although this can only be confirmed once the proposed legislation has been made available in this regard) and would therefore be in the same position in terms of the proposed amendments as compared to the current legislation.

In regard to the former (i.e. the primary research question), this study found that, based on the literal interpretation of the wording contained in section 20, a taxpayer company which does not derive any 'income' from its trading activities during the current year of assessment would not be allowed to carry forward its balance of assessed loss determined at the end of its previous year of assessment. This study also found that the mere existence of section 20(2A)(b) is an indication that an 'income' requirement may exist, but it would have to be confirmed in our superior courts whether it should be taken into account in determining whether a company would be allowed to carry forward its balance of assessed loss from the preceding year of assessment as a result of having derived no income from its trading activities.

This study determined that an assessed loss could arise in two different scenarios, which could be classified as the First Scenario (i.e. deductible expenditure which exceeds income) and the Second Scenario (i.e. deductible expenditure with no corresponding income in the same year of assessment). In this regard this study found that our courts have determined that section 20(1) envisages the accumulation of assessed losses (i.e. the current year's assessed loss is added to the balance of assessed loss determined at the end of the previous year of assessment in order to determine a new and larger balance of assessed loss) in the event where a taxpayer had conducted a trade for which an assessment had been issued. The aforementioned accumulation of assessed losses clearly falls within circumstances contemplated in the First Scenario.

This study also found that a superior court has not yet interpreted section 20(1) in terms of the current approach to the interpretation of statutes, which not only considers the wording of the section, but provides that the wording of the section must be considered in the light of the context in which it appears, and should also consider the apparent purpose to which it is directed at as

well as the relevant background material known to the drafters of the relevant provision. It is submitted that a superior court which takes into account these principles may come to the conclusion that section 20(1) essentially deals with the carrying forward of assessed losses from trading activities, and would therefore not treat a company which falls within the circumstances contemplated in the Second Scenario (i.e. deductible expenditure with no corresponding income in the same year of assessment), any differently to a company which falls within the circumstances contemplated in the First Scenario (i.e. deductible expenditure which exceeds income). It is submitted that a superior court may therefore hold the view that a company would be allowed to carry forward its balance of assessed loss determined at the end of its previous year of assessment to its current year of assessment, even though it had derived no 'income' from its trading activities during its current year of assessment.

As a concluding note I recommend that the term "*set off against the income*" be re-worded in order to remove the debate as to whether there is or is not an 'income' requirement in section 20(1).

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