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CONTENTS

1.	INTRODUCTION	1
2.	ASSESSED LOSSES	3
2.1	Definition	3
2.2	"balance of assessed loss"	3
3.	SET OFF OF ASSESSED LOSSES	4
3.1	Companies	4
3.1.1	the trade requirement	6
3.1.2	the income requirement	13
(a)	addition or accumulation of assessed loss	14
(b)	meaning of "income"	32
3.1.3	s 103(2)	35
3.1.4	compromise with creditors: s 311 of Act 61 of 1973	45
3.2	Taxpayers other than Companies	49
4.	GROUP TAXATION	50
4.1	Arguments Against	54
4.2	Arguments In Favour	55
4.3	View Based on Analysis of Contra and Pro Arguments	55
5.	CONCLUSION	57
	BIBLIOGRAPHY	61

1. INTRODUCTION

Income tax has been and will continue to be the subject of much emotion, in some instances the distinction between tax evasion and tax avoidance being blurred beyond comprehension. MacDonald JP once vented his judicial spleen and hurled his person, with respect rather unceremoniously, armed with gown and gavel (perhaps much to the relief of the taxpayer's counsel), into a hysteria of emotional outburst as follows:

[T]he avoidance of tax is an evil. Not only does it mean that a taxpayer escapes the obligation of making his proper contribution to the *fiscus*, but the effect must necessarily be to cast an additional burden on taxpayers who, imbued with a greater sense of civic responsibility, make no attempt to escape or, lacking the financial means to obtain the advice and set up the necessary tax-avoidance machinery, fail to do so. Moreover, the nefarious practice of tax avoidance arms opponents of our capitalistic society with potent arguments that it is only the rich, the astute and the ingenious who prosper in it and that 'good citizens' will always fare badly. While undoubtedly the short term effects of the practice are serious, the long term effects could be even more so.¹

It is rumoured that this outburst owes its origin to the frustration felt by those whose allegiance lied with the government of Ian Smith in the then Rhodesia which was in danger of being ousted and lacked, among other things, the revenue with which to stave off its opponents. Whatever its origins, his Lordship's ire was, with respect, misplaced. It is generally accepted in the world of income tax that tax avoidance is a legitimate and perfectly legal way of reducing one's total income tax bill by using applicable legislation and practice to one's own best advantage. Tax evasion, on the other hand, is an illegal practice of, among other things, lying and falsifying records in order to avoid paying income tax that is commensurate with the income that, but for the lying and falsification, rightly accrues to or is received by the taxpayer. MacDonald JP thus erred immensely in employing words with

¹ *COT v Ferera* 1976 (2) SA 653 (RAD) at 655

reference to tax avoidance that are, in my view, more suited to the damnation that the evasion of tax warrants.

Inasmuch as no reasonable person is so imbued with a greater sense of civic responsibility that he harbours unparalleled enmity against anyone who pays more tax than he² -- in fact the opposite is true -- taxpayers generally spend large sums of money on tax planning schemes to reduce their income tax bills as far as possible. Assessed losses, for those companies³ who carry on a trade or a number of trades, are but one set of tools that lends itself to much utility in escaping (at least to an extent) the dreaded clutches of that ubiquitous being called the Receiver⁴ of Revenue. Thus, the reduction of current year's taxable income by the amount of assessed loss incurred in any previous year of assessment, coupled with brief accounts of what taxpayers may learn from some of the reported judgments on this topic, forms the basis of discussion in this paper. Set-off of one trade's assessed loss against the income of another in the same year of assessment, together with the effects of group taxation on the utilisation of assessed losses, will also be explored.

² Except for those whose purses know no bounds to philanthropy -- a very rare breed indeed.

³ It is not a requirement that a natural person should carry on a trade in order to set off assessed losses against the income. See s 20(2A) of the Act.

⁴ He must have been a kind man who imposed such a grossly unfitting sobriquet on the taxman, for if he merely receives revenue like a beggar, he is certainly a most ungrateful beggar that ever treaded this earth as his receipts know little bounds. It is for this reason that I should rather insist on adorning the taxman with a comparatively less flattering appellation -- Commissioner.

2. ASSESSED LOSSES

2.1 Definition

Assessed loss is defined in section 20(2) of the Income Tax Act⁵ ("the Act") as:

any amount by which the deductions admissible under sections *eleven to nineteen*, inclusive, exceeded the income in respect of which they are so admissible

This definition can be illustrated in the following manner -

	Gross income	xxx
less:	Exempt Income	(xxx)
	Income	xxx
less:	Admissible deductions	(xxx)
	Assessed loss	(xxx) <small>→ taxable income</small>

It cannot, in my respectful view, be disputed that "the income" in the above definition refers to income as defined in section 1 of the Act -- that is, any amount remaining after deducting exempt income from gross income. What is more, the phrase cannot refer to taxable income which arises only where income as defined exceeds admissible deductions.

2.2 "balance of assessed loss"

Under section 20 of the Act not only are assessed losses incurred by the taxpayer during the year of assessment capable of being set off against the income accrued to or received by the taxpayer during the same year of assessment; assessed losses incurred in any

⁵ No. 58 of 1962

previous year which have been carried forward from the preceding year of assessment can also be set off against the income accrued or received in the current year of assessment.

Thus, "balance of assessed loss" arises in one of two circumstances:

- (1) where the assessed loss incurred in the previous year of assessment exceeds the taxable income of the current year of assessment; and
- (2) where the cumulative assessed losses of two or more trades exceed the taxable income of another trade (or cumulative taxable incomes of other trades) of the same taxpayer derived in the same year of assessment.

3. SET OFF OF ASSESSED LOSSES

3.1 Companies

Before a company can utilise its assessed loss to reduce its taxable income it must first meet the following requirements:

- (a) it must carry on a trade⁶;
- (b) it must earn the income⁷ against which such assessed loss must be set off⁸;
- (c) it must not conclude any agreement, whether such agreement pertains to the

⁶ s 20(1); *SA Bazaars (Pty) Ltd v CIR* 1952 (4) SA 505 (A)

⁷ "Income" in this context means "taxable income". See below for a more detailed discussion hereon.

⁸ *ITC 664* (16 SATC 125)

administration of the company's business or to change of shareholding in the company, the sole or main purpose of which is to utilise the company's assessed loss or balance of assessed loss, thereby reducing or avoiding the company's liability to pay any tax⁹.

In addition to the above requirements the Act imposes two further restrictions on the set off of assessed loss against a company's income. First, no person (including a company) may carry forward to the next year any assessed loss incurred prior to the date of final liquidation for set-off against income received after that date unless the final liquidation order has subsequently been set aside¹⁰. The second restriction is that the company's balance of assessed loss must be reduced by the amount or value of any benefit received by or accruing to the company as a result of a concession granted by or compromises reached with its creditors in terms of which its liabilities to them are reduced or extinguished, provided that such liabilities arose in the ordinary course of the company's trade¹¹.

It is now appropriate to examine the requirements for the utilisation of assessed loss in greater detail.

⁹ s 103(2)

¹⁰ s 20(1)(a)(i)

¹¹ s 20(1)(a)(ii). See p 45ff below for some examination of case law hereon.

3.1.1 the trade requirement

It is imperative that a company should, in order to be able to set off any assessed loss that it may have incurred in a particular year against the income that it may have earned in a subsequent year, carry on a trade. Because of the provisions of section 20(2A) of the Act¹², the trade requirement appears, by implication, to apply exclusively to companies. What is more, the courts have been very consistent in their findings that a company which fails to carry on a trade in any year subsequent to that in which it incurred an assessed loss thereby loses the assessed loss irretrievably¹³.

In *ITC 664*¹⁴ the facts, which were not in dispute, were that the taxpayer had carried on a trade and derived income therefrom. For the year of assessment ending at 30 June 1929 it had an assessed loss of about 37 000 pounds. From 1930 to 1944 the taxpayer did not trade and so earned no income from trade. It resumed trade in the 1945 year of assessment from which it earned income and sought to set off the assessed loss it had incurred in 1929 against the income it earned in 1945. The Commissioner determined the taxpayer's assessed loss to be nil for each of the 1930 to 1945, inclusive, years of assessment. The taxpayer's objection on the ground that it was, in terms of s 11(3)(a) of the 1925 Income Tax Act¹⁵ (Act 40 of 1925), entitled to have the said assessed loss carried forward in each succeeding

¹² The subsection absolves non-company taxpayers from both the trade and income requirements.

¹³ *ITC 664* (16 SATC 125); *SA Bazaars (Pty) Ltd v CIR* 1952 (4) SA 505 (A); *obiter* in *New Urban Properties Ltd v SIR* 1966 (1) SA 217 (A); *ITC 1476* (52 SATC 141).

¹⁴ *supra* footnote 12

¹⁵ An equivalent of the present s 20(1)(a)

year up to and including the 1945 year of assessment having been disallowed, appealed to the Special Court.

The Special Court held that inasmuch as the taxpayer had not traded since the 1929 year of assessment, and so earned no income *in each of the years subsequent thereto*¹⁶ against which the assessed loss it had incurred in 1929 could be set off, it could not invoke the provisions of the section. The crux of the matter is contained at 126 of the report:

In the case where [the balance of assessed loss] has been ascertained ... and has been carried forward from the preceding year of assessment, then such balance is to be set off against the income of the next succeeding year of assessment for the purpose of arriving at the taxable income of the year... . But it is to be noted that to allow the set off to operate, the balance must be carried forward from *the* preceding year of assessment. The Act does not contemplate the set off of a balance of assessed loss not so derived. (emphasis in text)

It should be emphasised, in my view, that it is not a requirement that a taxpayer company should not trade for a number of years in order to lose its assessed loss irretrievably. Failure to trade in the year immediately following the one in which the assessed loss was incurred, even if trade is resumed in a subsequent year, will result in the taxpayer losing its assessed loss irretrievably. This point was emphasised by the Appellate Division in *SA Bazaars (Pty) Ltd v CIR*¹⁷ when Centlivres CJ said at 510 of the report:

¹⁶ My emphasis

¹⁷ *supra* footnote 12

As in my view the appellant was not entitled in respect of the year ending on 30 June 1944 to set off the sum [7 623 pounds it had incurred in the 1941 and 1942 years of assessment] in its income tax return, it follows that it was not entitled, in view of the provisions of s 11(3), to set off that sum in respect of any succeeding year.

The Appellate Division in *SA Bazaars (Pty) Ltd v CIR*¹⁸ was confronted with facts similar to those with which the Special Court was engaged in *ITC 664*¹⁹, except for one difference which the former court found not to amount to carrying on a trade in any event. In the *SA Bazaars* case the taxpayer incurred trading losses as a result of which it was decided that its business should be closed. That was done in November 1941. For the year of assessment ending on 30 June 1942 the taxpayer had an assessed loss of 7 623 pounds. It was common cause that during the 1943 to 1947, inclusive, years of assessment the taxpayer did not trade, and so the Commissioner determined its assessed loss for each of those years to be nil. The taxpayer resumed trade in 1948 and 1949 and earned income against which it sought, unsuccessfully, to set off the assessed loss it had incurred in 1941 and 1942. Although the taxpayer did not actively trade during the five year period referred to above, it maintained its banking account, obtained transfer of its trading licences to different premises which licences it renewed annually, paid income tax and licence duty, held annual general meetings and prepared annual accounts in which it disclosed that its assessed loss had been carried down from year to year in its books. The court held that, at best, all these activities amounted to the taxpayer "keeping itself alive" and not the carrying on of

¹⁸ *supra* footnote 13

¹⁹ *supra*

trade, notwithstanding any intention the taxpayer may have had to resume its trading activities at a future date²⁰.

In a more recently reported case, *ITC 1476*²¹, the court was tasked to determine whether or not the taxpayer carried on a trade during the year of assessment in which it earned an income against which it sought to set off assessed loss incurred in the previous year. The facts, which were not in dispute, were as follows: The taxpayer company was incorporated in 1969. In 1970 it purchased immovable property, erected a block of flats and offices thereon, opened a sectional title register and sold off the individual units. In 1982 another company acquired all the shares in the taxpayer and the taxpayer was then used as an investment vehicle in property speculating companies. From that year the taxpayer invested in a number of companies that speculated in immovable property and made interest-free loans to them. Between 1982 and 1987 the taxpayer made no attempts to call back the loans nor did it call for interest thereon. At the close of its 1986 year of assessment the taxpayer had an assessed loss. The following year it derived interest of R574 from monies deposited by it at a bank. It had no other income for that year. The taxpayer then sought to set off the 1986 assessed loss against its income for the year ending 1987. The taxpayer's objection having been disallowed by the Commissioner, it appealed to the Special Court.

The Special Court expressed the view that the carrying on of a trade involves an

²⁰ at 510G-H

²¹ 1995 *Taxpayer* 53

active step -- something more than merely watching over existing investments which are not, and are not intended or expected to be, income producing²². The court then took account of all the taxpayer's activities during the year under consideration and said²³:

In the year of assessment the only income the [taxpayer] enjoyed was a small amount of interest which, on the probabilities, was derived from money in the bank; this amounted to approximately 2,5 per cent of the money on deposit with the bank -- hardly a profitable investment... . The audit fees were less in 1987 than they were in 1986 and the secretarial expenses for the year amount to R2,29. All this indicates inactivity by the [taxpayer]. The only other expense was 'printing, stationery, telephone, sundries' which in 1986 had amounted to R248 but in 1987 was less than half, ie R120 or R10 per month. What business endeavour does this expenditure indicate? It barely covers the rental of a telephone -- let alone the use of a telephone. The [taxpayer] incurred no expense for office rent or salaries. There were no travelling or advertising expenses. This is all an indication of no activity at all and the R10 per month is indicative merely of a nominal charge under a globular heading.

One can readily assume that "nominal charge under a globular heading" is judicial euphemism for "a thumbsuck" or, at worst, "a blatant lie". The court then concluded that the taxpayer was totally inactive in 1987 inasmuch as all it did was hold shares and retain investments made prior to the 1987 year of assessment which needed little, if any, supervision as no dividend or interest was to accrue therefrom²⁴.

What lessons can be learned, *ex post facto*, from these judgments pertaining

²² at 58

²³ at 58

²⁴ at 58

specifically to the trade requirement? The first lesson, in my view, is that if a taxpayer company should incur an assessed loss which it desires to set off against income in the future, then it must make sure that it continues trading until the assessed loss has been exhausted. It is, in my view, not necessary that the taxpayer should carry on a trade throughout the year following the one in which the assessed loss was incurred. Although it is not clear, in my view, whether the court will consider the length of the period during which the taxpayer traded, or the volume of trade carried on, in ascertaining whether or not the taxpayer has carried on a trade, it can fairly be expected that each case will be judged on its own merits depending, among other things, on the type of trade involved. For example, a large retail business (like Pick 'n Pay) which purchases nothing, sells nothing, incurs no advertising costs, pays remarkably low electricity and telephone bills, pays no audit fees and rental expenses until a month before the end of its year of assessment -- at which time it starts trading frantically -- will, in my view, find it very difficult to convince the court that it carried on a trade in that year. What is more, such taxpayer could even be in danger of the application of the provisions of s 103(2) against it.

On the other hand, however, an advocate who fails to earn the elusive pittance of his cronies at the side bar²⁵ and sits idly in his chambers the entire year without any briefs coming his way²⁶, can nonetheless be considered to have carried on a trade during that

²⁵ Now that many Attorneys also enjoy a right of audience in the higher courts, I suppose they are also deserving of the appellation -- Barrister.

²⁶ This is far from inconceivable in today's Bar

year.²⁷ This is because advocates are, by the ethical rules of their trade, precluded from yelling "Cherry Ripe, Cherry Ripe" of their robed wares on pavements and court precincts.

The taxpayer must, therefore, at least do many of the things that a person in that line of trade would do in the ordinary course of trade. A retail business does not, ordinarily, trade for one month and then close its books for the year.

Secondly, it is crucial that the taxpayer should carry on a trade in the year immediately following the one in which the assessed loss was incurred even if the intention is to set off the assessed loss against the income of the subsequent year. This principle is borne out clearly by the cases of *ITC 664* and *SA Bazaars (Pty) Ltd v CIR* above.

Thirdly, the mere *intention* to carry on a trade is not sufficient to constitute the carrying on of a trade. The taxpayer must take an active step to carry on a trade. However, where a property company attempts to let its property, that would amount to the carrying on of trade even if no actual letting ensues²⁸. The endeavour to let does constitute an active step.

Fourthly, the taxpayer must carry on *its* particular trade and not *any* trade²⁹. A

²⁷ In any event, it is not a requirement that natural persons should carry on a trade in order to set off assessed losses against income. See s 20(2A) of the Act.

²⁸ *ITC 777* (19 *SATC* 320 at 321 - 322)

²⁹ *ITC 777 supra* at 321

property company which, throughout the year, does nothing in the nature of that business but buys and sells shares, does not carry on a trade for the purposes of s 20 because it is not a share-dealer.

Finally, "keeping itself alive" by maintaining its bank account, holding annual general meetings, renewing trading licences, paying income tax and keeping accounting books does not constitute the carrying on of a trade³⁰.

3.1.2 the income requirement

The second requirement which, it has been held by the courts, a taxpayer company must meet in order to utilise its assessed loss is that it must have earned income against which the assessed loss can be set off. Two questions arise in this regard, and these are, firstly, whether s 20 envisages the addition of an assessed loss incurred in the subsequent year to that carried forward from the previous year. In other words, the first question that arises is whether or not the section envisages the accumulation of assessed losses, with the result being a larger assessed loss in the subsequent year of assessment capable of being carried forward to the next year for set off against the income that the taxpayer may earn in the latter year. The second question that arises is what is meant by "income" against which an assessed loss may be set off for purposes of the section? I attempt to unscramble this omelette³¹ below. I propose to begin with the accumulation argument for purposes of set-off

³⁰ *SA Bazaars (Pty) Ltd v CIR supra*

³¹ I borrow Harms JA's metaphor at 95 of his Lordship's judgment in *Conshu (Pty) Ltd v CIR infra*.

and then, under a separate sub-heading, proceed with the discussion of the proper construction of the word "income" in the context in which it appears in the introductory part of s 20.

(a) **addition or accumulation of assessed loss**

In *ITC 664*³² Ingram KC gave a strict interpretation to s 11 of the 1925 and 1941 Income Tax Acts³³ and said, albeit *obiter* inasmuch as it was not necessary to decide the point on the facts of that case³⁴, that where a taxpayer company -- having incurred an assessed loss in the *previous* year (year 2) or having carried forward a balance of assessed loss from the *preceding* year (year 1) to the year preceding the *subsequent* year (year 3) of assessment (ie to the previous year -- year 2) -- traded in the *subsequent* year (year 3) of assessment and derived no income but incurred a further assessed loss, such taxpayer could not invoke the section as there is no income against which the balance of assessed loss brought forward from the previous year could be set off. The learned judge said:

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, ie 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

³² *supra* at 126 - 127

³³ This section in both Acts has a provision which is the equivalent of s 20(1) of Act 58 of 1962.

³⁴ The taxpayer having failed to clear the trade requirement barrier.

that there shall be set off against the *income* the amounts permitted under subsection (3). It follows, therefore, that in any given year there must be some *income* ... against which the set-off can operate... *(Italics in text)*

Subsection (3) of s 11 of both³⁵ the 1925 Income Tax Act and the 1941 Income Tax Act contain substantially similar provisions as subsections (1) and (2) of s 20 of Act 58 of 1962.

What is more, it is clear from the court's judgment that in the event of the taxpayer neither deriving income nor incurring a loss in the year of assessment -- that is, where the company breaks even -- the taxpayer would still be precluded from setting off an assessed loss or balance of assessed loss against the nil income. The court, at 127, said that where there is no income "all that is revealed in such a case is a minus quantity not a balance." It is not clear, however, what the court was referring to by "minus quantity". However, inasmuch as that term appears to be used as an antonym of "balance", it would seem that by it the court was referring to assessed loss. If this were a correct interpretation of the court's idiom, and it is respectfully submitted that it is correct inasmuch as such interpretation is consistent with the court's view that the section under consideration does not envisage an addition of the current year's assessed loss to the previous year's balance of assessed loss, then it appears that the court assumed that where there is no income against which to set-off an assessed loss there is necessarily a trade loss which precludes a set-off, since the section does not envisage a larger balance after set-off. In other words, it appears that the court interpreted "balance" as a lesser amount than the amount brought forward from the previous

³⁵ It is necessary to have regard to both Acts inasmuch as the events giving rise to the cause of action in this case spanned through the operation of both.

year so that an amount that would give rise to an amount larger than the amount so brought forward for set-off would not result in a balance of assessed loss but a minus quantity that would constitute a new assessed loss -- the assessed loss or balance of assessed loss brought forward from the previous year having been irretrievably lost for lack of income -- to be carried forward to the next year for set-off.

In *SA Bazaars (Pty) Ltd v CIR*³⁶, Centlivres CJ left the question open of whether a taxpayer would have been entitled to set-off a balance of assessed loss if it carried on a trade but derived no income.

Contrarily, in *CIR v Louis Zinn Organisation (Pty) Ltd*³⁷, Schreiner ACJ made an *obiter* remark suggesting that a trade loss in the year of assessment can be added to, or accumulated with, the assessed loss or balance of assessed loss of the preceding year thus resulting in a larger balance of assessed loss to be carried forward to the next year. His Lordship said³⁸:

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

³⁶ *supra* at 510

³⁷ 1958 (4) SA 477 (A)

³⁸ at 485 *in fine* - 486 *in principe*

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.* (My italics)

The above suggestion is also apparent in Beyers JA's *obiter dictum* in *New Urban Properties Ltd v SIR*³⁹ when his Lordship, referring to the facts in *SA Bazaars*, said⁴⁰:

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 ... there was nothing against which the balance of assessed loss could be set off in that year.* (My italics)

For reasons that appear below, the allusion (if allusion it is) to the effect that s 11(1) of Act 40 of 1925 and Act 31 of 1941 is capable of a construction that permits an accumulation of the previous year's assessed loss with the trading loss incurred in the year of assessment thus resulting in a larger balance of assessed loss is, with respect, not consistent with the wording of that section.

In *Conshu (Pty) Ltd v CIR*⁴¹ the courtly personages, with respect, appear to have fallen victim to troubled slumber if one considers the respective judgments delivered by the learned Judges of Appeal pertaining not only to the question now under consideration but also to other issues with which the court was seized. I propose to discuss this case later in this paper when I consider the veracity of certain judicial pronouncements in light of the

³⁹ 1966 (1) SA 217 (A)

⁴⁰ At 224

⁴¹ 1994 (4) SA 603 (A) (1995 *The Taxpayer* 87)

provisions concerning set-off. For now, it suffices to state that EM Grosskopf JA's *obiter dictum* suggesting that s 20 is capable of a construction that permits of an accumulation of assessed losses is, with respect, not a correct interpretation of the section.⁴²

Both Act 40 of 1925 and Act 31 of 1941 contain a provision that is substantially similar to that contained in the introductory part of s 20 of Act 58 of 1962, as amended. On the one hand, section 11(1) of these two Acts, under the heading "Determination of taxable income", reads:

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. (My italics)*

Section 7 of the said Acts, which is a definitions section, reads:

"income" means the amount remaining of the gross income of any person for any such year or period after deducting therefrom any amounts exempt from normal tax under this Chapter.

On the other hand, s 20(1)(a) of Act 58 of 1962, as amended (omitting the irrelevant provisos), reads:

For the purpose of determining the taxable income derived by any person from carrying on any trade within the Republic, *there shall be set off against the income so derived by such person --*

- (a) any balance of assessed loss incurred by the taxpayer in any previous year which has been carried forward from the preceding year of assessment. (My italics)**

⁴² An argument against this interpretation of the section is set out below.

It is submitted, with respect, that *ITC 664*⁴³ was correctly decided on the wording of the section there under consideration as it stood at the date of the decision in respect of the income requirement for purposes of set-off. Use of the phrase "deducted from" in the earlier legislation -- which in my view ought to be construed *eiusdem generis* or conjunctively rather than as an alternative of or disjunctively with , or mutually exclusive with, "set-off" -- presupposes an amount from which a deduction will be effected. Thus the section envisages two amounts, one positive (income or credit balance) and another negative (loss or debit balance), the one (the loss or debit balance) to be deducted from the other (the income or credit balance) resulting in a smaller loss or debit balance to be carried forward for possible set-off to the next year or, alternatively, resulting in no further loss or debit balance but a smaller income or pre-tax credit balance (and thus effectively reducing the amount of income tax payable).

It is respectfully submitted further that, had the legislature intended an accumulation of assessed losses from trade year to trade year, a provision would have been included to that effect. It is, in my view, reasonable to assume that the legislature would be alive to that possibility. I therefore submit, with respect, that if one applied the rule *unus expressio, alterius exclusio* one would come to the reasonable conclusion that in the 1925 and 1941 Acts the legislature could not have intended an accumulation of assessed losses from year to year, and that income⁴⁴ was a requirement for invoking the set-off provision.

⁴³ *supra*

⁴⁴ More about the proper construction of "income" below.

What then is the position under the 1925 and 1941 set-off provision where the taxpayer incurred no losses and derived no income but broke even in the year of assessment? Inasmuch as the section provided for a *deduction from income*, it is my respectful view that the same principle that applies where the taxpayer incurred a loss is equally applicable in this scenario. In a word, therefore, if the taxpayer derives no income in the year of assessment, "however small"⁴⁵, whatever assessed loss may have been carried forward is irretrievably lost. Put differently, as long as the taxpayer earns some income in the year of assessment, however small, it is entitled to set-off the assessed loss brought forward against such income thus giving rise to a new balance of assessed loss to be carried forward to the next year for set-off. What is more, if the taxpayer incurs a trade loss it is that loss, and not the sum of such loss and assessed loss or balance of assessed loss brought forward from the previous year, that will be taken into account for purposes of set-off against the following year's income.

It is of interest to note that in *New Urban Properties*⁴⁶ Beyers JA, in dealing with the taxpayer's contention -- which his Lordship considered as "ingenious, but somewhat unrealistic and fallacious" -- that the effect of s 90(1)(b)⁴⁷ was to reduce the taxpayer's trading income for purposes of s 11(1) and (3) to nil against which the assessed loss could be set off thereby resulting in the preservation of the balance of assessed loss brought

⁴⁵ *ITC 664 supra* at 126

⁴⁶ *supra* at 225

⁴⁷ The equivalent of s 103(2) of Act 58 of 1962.

forward from the preceding year to be carried forward to the next year, his Lordship said that this did not take the matter any further inasmuch as such nil income would, in any event, notionally still be "the same income against which any set-off of assessed loss is expressly forbidden by s 90(1)(b)." This response, in my view, seems to be capable of the interpretation that if s 90(1)(b) (or s 103(2)) was not applicable, the previous year's assessed loss or balance of assessed loss could be set off against the nil income of the current year thus giving rise to a new balance capable of being carried forward to the next year. However, because of the manner in which s 11 of Act 40 of 1925 and Act 31 of 1941 was worded, it is submitted that such argument would be doing violence to the wording of that section as it stood.

Consonant with the submissions made above, it is my respectful view that even if the taxpayer in the *SA Bazaars*⁴⁸ case had carried on a trade during the year there in question but derived no income⁴⁹, the taxpayer would not have been able to invoke the set-off provision because of the income requirement.

What is the position under s 20 of Act 58 of 1962 in respect of the income requirement? The section differs, in my view materially, in its wording from Act 40 of 1925 and Act 31 of 1941. Firstly, the phrase "deducted from" has been omitted and, secondly, the clause "as defined in section seven" which qualifies "income" (and which would read "as

⁴⁸ *supra*

⁴⁹ The court did not have to decide the question inasmuch as the taxpayer failed the trade requirement.

defined in section one" in the current Act) has been dispensed with. I shall deal with the significance of the second omission when I consider the context in which "income" is used in the introductory part of the section.

In my view, the omission of the phrase "deducted from", which was contained in the equivalent provision in s 11(1) of both Act 40 of 1925 and Act 31 of 1941, in s 20(1) of Act 58 of 1962 is significant. If this phrase were construed conjunctively with "set-off", which I submit is the only reasonable interpretation, then its omission is perhaps an indication, it may be argued, of the legislature's intention to depart from a strict requirement of trade income before set-off can be effected.

Having said that however, it now behoves me to offer a brief analysis of s 20(1) of Act 58 of 1962 and then test the veracity of some judicial pronouncements against the provisions of the section. The section clearly makes provision for the set-off, *against the income*, of any assessed loss or balance of assessed loss. The term "set-off", in my view, envisages a pitting of two *opposite* things against each other. Semantically, one cannot set-off a positive number against another in much the same way as one cannot set-off one negative number against another. One can perhaps add two positives together and two negatives together. The result of a set-off (which is really a synonym for subtraction) ought to be a smaller number than the one with which one started, whether such result is a positive number or a negative number. An arithmetic process, therefore, that results in a larger number of the same kind as that with which one started (ie. negative and negative or positive

and positive) is not a set-off. A "set-off" of one negative against another is in effect an addition and not a set-off. Therefore, the bringing together of one assessed loss with another, thus resulting in a larger assessed loss, is not a process capable of being called a set-off. It is rather an addition.

What is more, it is *against the income* derived from trade that the section envisages that set-off should be effected. The introductory part of the section does not, in my view, lend itself to the interpretation that set-off can be effected where there is no income in the year of attempted set-off. Moreover, the express provision in s 20(2A)(b), which deals with natural persons, to the effect that a taxpayer shall not be precluded 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 is of considerable significance for two reasons. First, the fact that a similar provision is not included among the provisions that deal with companies⁵⁰ is indicative of the intention that companies must derive trade income in the year of assessment in order to effect a set-off. Second, inasmuch as s 20(2A)(b) envisages the accumulation of assessed losses the term "set-off" is not used. This, in my view, indicates that an accumulation of assessed losses is not capable of being termed "set-off".

In light of the above arguments, I now propose to discuss the following statements from both judgments in the *Conshu* case in relation to the income requirement thereby testing

⁵⁰ It is reasonable to infer from subsection (2A), inasmuch as it expressly applies to taxpayers other than companies, that the other provisions of s 20, to the extent that they are inconsistent with subsection (2A), apply exclusively to companies.

the veracity of each against the relevant provisions of s 20 and the manner in which the section (or its equivalent) was applied and interpreted in other decisions on the income requirement aspect.⁵¹ The first statement, which was made by Harms JA at 94, reads:

[A] set-off in terms of s 20 can only arise if there would otherwise have been taxable income, ie pre-tax profit.

EM Grosskopf JA, in his minority judgment, interpreted the above *dictum* to mean that "set-off can operate only after the deductions have been made, and only if there then remains a profit"⁵². Although Harms JA's statement is open to the interpretation given it by EM Grosskopf JA, it is respectfully submitted that perhaps that is not what Harms JA intended to convey thereby. If it is what the learned Judge of Appeal intended to convey, then it is submitted with respect, and for reasons that are set out below,⁵³ that s 20 is indeed capable of that interpretation. Nevertheless, it is considered that Harms JA was, by the statement, at pains to offer an analysis of the meaning of the word "income" as used in the introductory part of s 20, rather than to give an opinion as to whether or not a taxpayer company must have made a profit for set-off to be effected. In other words, what Harms JA was emphasising was that set-off of assessed loss cannot be effected against "income" as defined but that one must have reached the taxable income/assessed loss stage in order to effect a set-

⁵¹ Although any comments in the *Conshu* case in respect of s 20 were *obiter*, they nevertheless deserve serious consideration as they have immense practical implications. The case was on the construction and application of s 103(2).

⁵² at 98

⁵³ See 32 - 35 below.

off.

The second statement that warrants comment is that made by EM Grosskopf JA at 98 of his minority judgment of the same case. His Lordship said:

Section 20 does not require for its application that the taxpayer must have made *a profit* during the relevant year of assessment. Indeed, there is a school of thought that s 20 may be applied even where no *income* was earned during the relevant year of assessment, provided only that the taxpayer carried on a trade... . It is not necessary for me to pronounce on this point. 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. (My italics)

The seeming contradiction in EM Grosskopf JA's judgment of holding that the section applies notwithstanding that the taxpayer makes no trading profit in the year of assessment in question, but declining to pronounce on the question of whether the section applies where the taxpayer earns no income in such year, owes its origin to the learned Judge of Appeal's interpretation of the word "income" in the introductory part of the section. His Lordship construed "income" -- erroneously in my respectful view -- in its ordinary meaning as defined in s 1 of the Act (that is, gross income *less* exempt income) and thus "trading profit" as pre-tax income (or taxable income) after allowable deductions have been subtracted from income as defined⁵⁴. It appears to be in this light that the learned Judge of Appeal understood use of the word "income" in the authorities cited by his Lordship at 98. What is more it is, in my view, a glaring contradiction that his Lordship should appear to accept

⁵⁴ See 33 below.

without question that set-off of assessed loss is effected "against income under s 20(1)(a)" but decline to pronounce on the question of whether income is a requirement for set-off to be effected.

Moreover, and with the greatest respect to the learned Judge of Appeal, the three cases cited as authority for the view that s 20 is applicable even where no income is earned during the relevant year of assessment do not support that view. While *ITC 664* is in fact authority for the contrary view, both *ITC 777* and *SA Bazaars* did not pronounce any view on that question. In the latter judgment the question was expressly left open, while in the former *Neser J* simply stated that it was not contended on the Commissioner's behalf that the taxpayer was not entitled to a set-off merely because it had no income in the year of assessment, and there left the matter.

For reasons already given above, it is respectfully submitted that EM Grosskopf JA's view that a set-off is permissible under s 20(1)(a) notwithstanding that the taxpayer has derived no taxable income or "profits" in the year of assessment is incorrect.

Thirdly, EM Grosskopf JA said:⁵⁵

A particular assessed loss has a notional existence for only a single year of assessment.

⁵⁵ at 97

It is submitted, with respect, that his Lordship's statement, given its proper construction, is correct. In my view, the learned Judge of Appeal did not thereby mean that an assessed loss incurred in one year is not capable of being carried forward to the next year under any circumstances whatever. If this is what his Lordship intended to convey by the statement, then it is respectfully submitted that such construction is not consistent with the wording of the section under consideration. What EM Grosskopf JA intended to convey is that the assessed loss or balance of assessed loss arrived at in any year subsequent to that in which the original assessed loss was incurred has its own identity that is separate from that of the original assessed loss. Had a particular assessed loss not had a notional existence for a single year, then that would mean that the same assessed loss is capable of being set off against the income of each subsequent year. I attempt to illustrate this point by way of example:

<u>Scenario 1</u>			<u>Scenario 2</u>		
Yr 1	Assessed loss	(200)	Yr 1	Assessed loss	(200)
Yr 2	Income	100	Yr 2	Income	100
Yr 3	Income	100	Yr 3	Income	100
<hr/>			<hr/>		
Yr 4	Income/Assessed loss	nil	Yr 4	Assessed loss	(100)

Scenario 1 illustrates the position where an assessed loss has a notional existence for a single year, while scenario 2 illustrates the position where it does not. The end result is that in the former scenario the original assessed loss perishes with the end of the second year and the balance of assessed loss arrived at at the end of year 2 perishes with the end of the third

year, so that at the beginning of the fourth year there is no longer any assessed loss remaining. On the other hand, the end result is that the original assessed loss maintains its existence throughout and so is available for set-off at the end of year 3, notwithstanding the set-off that occurred at the end of year 2. It is respectfully submitted that it is the former position, as opposed to the latter, that EM Grosskopf JA sought to explain by the statement that an assessed loss has a notional existence for a single year; that the carrying forward of a particular assessed loss does not occur automatically from year to year.

What is more, the above meaning is borne out by his Lordship's statement⁵⁶ that:

at the end of each year of assessment a new balance is struck reflecting the effect of that year's trading on the balance of assessed loss brought forward from the preceding year... . [T]he loss assessed at the end of year 1 exists only during year 2. At the end of year 2 it is replaced by a new figure being either a profit or a loss. If at the end of year 2 the company still has an assessed loss, it is a different assessed loss from that with which it started the year. The assessed loss at the end of year 2 represents a balance between different items from those which made up the assessed loss in year 1. (My italics)

Having posited the hypothetical example set out below and considered scenario A below to be so inconsistent with the scheme of the Act that it would require clear language to achieve it, EM Grosskopf JA said:

As far as I know, [scenario B] is also the way in which s 20(1)(a) and its predecessors have been consistently applied in the past.

⁵⁶ At 97

The example posited by his Lordship can be tabularly illustrated thus:

<u>Scenario A</u>			<u>Scenario B</u>		
Yr 1	Assessed loss	(50 000)	Yr 1	Assessed loss	(50 000)
Yr 2	Income 20 000		Yr 2	Income 20 000	
	Exp. <u>(30 000)</u>	<u>(10 000)</u>		Exp. <u>(30 000)</u>	<u>(10 000)</u>
Yr 3	b/f	(10 000)	Yr 3	b/f	(60 000)

With respect, inasmuch as "income" was expressly used in its defined sense in the predecessors of s 20(1)(a), one may indeed correctly argue that scenario B reflects the manner in which the section was applied in the past. This is the manner in which EM Grosskopf JA construed the word "income" as used in the introductory part of s 20(1). If that were the context in which the word is used in s 20(1), then clearly the income requirement would have been fulfilled in the example and so a set-off of year 1's assessed loss could be effected against the 20 000 income in year 2 to arrive at 30 000. The 30 000 expenditure together with the result of such set-off would then constitute the new assessed loss to be carried forward to the next year -- ie 60 000. The expenditure of 30 000 is not an assessed loss but an admissible deduction. An assessed loss is, by definition, income as defined less deductions which exceed such income.

However, in s 20(1) "income" is used in the sense of taxable income and therefore whether or not the 50 000 assessed loss brought forward from year 1 qualifies for set-off in year 2 depends on the situation that prevails after allowable deductions from income (as

defined) have been made. If the income as defined is larger than the deductions, then the difference between the assessed loss brought forward and the taxable income of year 2 must be carried forward to year 3. But where the deductions more than swallow up the income as defined, then the balance of the deductions will constitute a new balance of assessed loss to be carried forward to year 3 -- as reflected in scenario A.

Are there any lessons from which taxpayers can learn in the manner in which the courts have dealt with the inquiry of whether or not one year's assessed loss can be accumulated with or added to the loss of another year? In my view there are none but confusion. Although the earlier cases decided on the basis of Act 40 of 1925 and Act 31 of 1941 were inconsistent⁵⁷ none of them expressly decided that an assessed loss of one year could be added to that of another thus resulting in a new "balance" of assessed loss. In at least two such cases⁵⁸ was the idea of an accumulation of assessed losses mooted, and there only in *obiter* remarks. In one⁵⁹, the court held that the provision there under consideration did not permit of an accumulation of assessed losses. Under Act 58 of 1962 the position is none the clearer. In the *Conshu* case the Appellate Division was split on the issue, with the majority holding the view (in an *obiter* judgment) that the set off provision can be invoked only where there would otherwise have been taxable income and the minority (also *obiter*) opining that the provision does allow for accumulation of one year's assessed loss with that

⁵⁷ See discussion at 14 - 21 above.

⁵⁸ See discussion of *Louis Zinn* and *New Urban Properties* above.

⁵⁹ See discussion of *ITC 664* above.

of another.

The authors on the subject have, with respect, contributed much to the uncertainty about the proper construction of the set-off provision. In one publication⁶⁰ the following appears:

The forfeiture of a loss brought forward from year 1 because in year 2 there is no income taxable but for the set-off of an assessed loss *is something entirely novel in the history and practice of set-off of losses.* (My italics)

With respect, there is nothing novel about the forfeiture of assessed losses of the previous year if the taxpayer has not earned income in the current year. *ITC 664*, albeit a lower court decision, is instructive on this question while in other reported cases the question was either left open or an *obiter* remark was made in regard thereto.

The author of the passage cited above goes on to state that:

[such forfeiture] could give a most anomalous result assuming that in year 2 there is some income of the required kind, but insufficient to absorb the whole assessed loss.

It is submitted, with respect, that all that is required by the section is that some income of

⁶⁰ 1996 *Taxpayer* 81 at 82.

the required kind, however small⁶¹, will suffice. It is certainly not a requirement that such income of the required kind must more than swallow up the assessed loss for the set-off provision to be invoked.

Another author, who holds the view that the word "income" is used in its defined sense in the introductory part of s 20(1), in evaluating the predecessors of s 20 of Act 58 of 1962 contends that "[a]n assessed loss from a previous year could therefore be utilized in a later year even though the taxpayer's activities in that year also resulted in an assessed loss, in which case the respective assessed losses could be added and carried forward to the next year"⁶² and cites as authority for this proposition the *Louis Zinn* case in which an allusion to the possibility of an accumulation of assessed losses was made but only *obiter*.

Silke⁶³ is silent on this question.

I now consider, in greater detail, the context in which the word "income" is, and indeed the only reasonable context in which it can be, used in my view.

(b) meaning of "income"

It is my respectful submission that the word "income" is used in the

⁶¹ See footnote 45 above.

⁶² GJ Swart (1996) 8 *SA Merc LJ* 119 at 125.

⁶³ *Silke on South African Income Tax* (Vol 2).

sense of taxable income in s 20(1), not only because the phrase that qualified "income" in s 11(1) of both Act 40 of 1925 and Act 31 of 1941 has been omitted from the current set-off provision, but also because an interpretation of the word in its defined sense would result in anomalous situations which, with respect, are inconsistent with the scheme of the Act.

The arithmetical process that is used to calculate "income", taxable income or assessed loss is the following:

	Gross Income	(1)
less:	<u>Exempt Income</u>	
	Income	(2)
less:	<u>Deductions</u>	
	Taxable Income / Assessed Loss	(3)

The first step is to determine gross income as defined. The second step is to determine income as defined by subtracting exempt income (s 10) from gross income. The third step is the determination of taxable income or assessed loss, as the case may be, by subtracting allowable deductions (s 11 to s 19) from income as defined. In a word, in order to ascertain whether there is taxable income or an assessed loss in respect of a particular trade, one must perform steps (1), (2) and (3). Therefore, having ascertained an assessed loss in step (3) of year 1 and carried it forward to the next year (year 2), it would be anomalous to set-off that assessed loss against (2) as that would be ignoring allowable deductions.

Moreover, s 20(1)(b) provides for the set-off of assessed loss incurred in the same

year of assessment against income derived in that year from another trade. In order to ascertain whether there is an assessed loss or income in each of the taxpayer's trades one has to perform all three steps in respect of each trade. Having arrived at an assessed loss in step (3) of the one trade and taxable income in step (3) of another, it would be anomalous to then set-off that assessed loss against income as defined (step 2) of another trade which has already been calculated. What is more, where the taxpayer carries on a number of trades, against which trade's income as defined does one set-off the cumulative assessed loss?⁶⁴ The problem can be illustrated thus:

	<u>Trade A</u>		<u>Trade B</u>		<u>Trade C</u>
Gross Income	100	Gross Income	150	Gross Income	100
Exempt Income	<u>(50)</u>	Exempt Income	<u>(70)</u>	Exempt Income	<u>(--)</u>
Income	50	Income	80	Income	100
Deductions	<u>(90)</u>	Deductions	<u>(90)</u>	Deductions	<u>(30)</u>
Assessed loss	(40)	Assessed loss	(10)	Taxable income	70

If the correct manner of arriving at the overall tax situation of the taxpayer in the above example is by setting off the assessed losses in trades A and B against the taxable income in trade C, which I submit is the correct manner, then it is easy to ascertain the overall position

⁶⁴ Where assessed losses are set-off against taxable income the overall position is arrived at by simply setting off the cumulative loss against the cumulative taxable income. It is respectfully submitted that this is not the same as accumulating assessed losses from year to year and then setting off the sum against a taxable income that arises a number of years down the line. Here we are talking about arriving at an overall position in one year of assessment.

as a taxable income of 20. However, if the said assessed losses are to be set off against income as defined, which I submit is not the correct interpretation of the section, the question that arises is against which of the three incomes such assessed loss is to be set off. Is it the sum of all three, the largest income, the smallest or the income of the trade that yielded a taxable income (ie. trade C)? There is no readily available answer. This illustrates one of the difficulties that might arise from setting off an assessed loss against income as defined.

It is clear that the word "income" was used in its defined sense in s 11(1) of both Act 40 of 1925 and Act 31 of 1941 and that is the context in which the courts interpreted it. However, in s 20(1) of Act 58 of 1962 it is used in the sense of taxable income for reasons stated above. It is therefore submitted that Harms JA's approach in *Conshu* that one must first arrive at step (3) in order to effect set-off⁶⁵ is, with respect, correct.

3.1.3 s 103(2)

The third requirement that a taxpayer must meet in order to be eligible to effect a set-off of assessed loss or balance of assessed loss against the taxable income of the current year is expressed negatively and that is that the taxpayer must satisfy the Commissioner that no agreement or arrangement has been entered into -- or no change in shareholding has taken place -- during the year of assessment, as a direct or indirect result of which taxable income was earned, solely or mainly for the purpose of utilizing any

⁶⁵ It is submitted that this is perhaps what Harms JA meant when he said at 94: "[A] set-off in terms of s 20 can only arise if there would otherwise have been taxable income, ie pre-tax profit."

assessed loss or any balance of assessed loss. In at least three Special Income Tax Court cases, *ITC 983*⁶⁶, *ITC 1347*⁶⁷ and *ITC 989*⁶⁸, the principle that emerges is that in order to avoid s 103(2) being successfully invoked, it is sufficient for the taxpayer to prove that even though the utilisation of assessed loss may have been one of the purposes for which an agreement or arrangement was entered into, it was nonetheless not the principal or sole purpose. A sound commercial reason should, depending on the facts, suffice.

*New Urban Properties Ltd v SIR*⁶⁹ is authority for the proposition that the effect of a successful application of s 103(2)⁷⁰ is that the assessed loss is altogether eliminated and cannot be carried forward to the next year of assessment for a possible set-off. The court held that once the section has been successfully invoked the continuity -- ie the year to year set-off thereof against taxable income -- that is essential for its preservation until it has been exhausted has been fatally interrupted and so cannot be revived. Counsel for the taxpayer sought to circumvent the continuity principle with the contention that the effect of the operation of the section was not to eliminate the assessed loss but to eliminate the income earned or accruing to the taxpayer as a result of the change in shareholding, so that the assessed loss is set-off against a nil income. This was an ingenious argument which the court

⁶⁶ 1963 *Taxpayer* 106

⁶⁷ 1986 *Taxpayer* 89

⁶⁸ 1963 *Taxpayer* 116

⁶⁹ 1966 (1) SA 217 (A)

⁷⁰ The court was there dealing with s 90(1)(b) of Act 31 of 1941 which is a predecessor to the current s 103(2).

acknowledged as such but dismissed as "somewhat unrealistic and fallacious".⁷¹ It is submitted that the court was, with respect, correct in its finding. The section provides that the set-off of an assessed loss against any income earned as a result of the events set out therein shall be disallowed. It does not say that any such income shall be deemed not to have been earned.

In *ITC 1123*⁷² the court held that s 103(2) applied not only to income diverted from others but also to income arising from within the taxpayer company with assessed losses itself through its own activities. In that case the taxpayer, a manufacturing company which was hopelessly insolvent, was taken over by a businessman who acquired all the shares therein, successfully sought an overdraft from a bank and proceeded, among other things, to dispose of the taxpayer's manufacturing machinery, lent money at interest and entered into transactions with other companies under his control -- all in the name of the taxpayer -- from all of which the taxpayer earned income. The court held that the Commissioner was correct in disallowing the set-off on the ground that, first, reference to "income ... received by or ... accrued to that company" rendered the section to be of wide enough import to include income produced by the taxpayer's own activities in contradistinction to income diverted to it and, second, that inasmuch as the section speaks of liability for tax "on the part of that company" in addition and in contradistinction to avoiding liability for tax "on the part of ... any other person" it is clear that not only diverted income but also income earned by

⁷¹ at 224

⁷² 1969 *Taxpayer* 208

the taxpayer itself from its own activities can fall within the purview of the section. It is respectfully submitted that the court was correct.

An old adage, "the law is an ass", often resorted to when all else has failed by litigants whose cases have not met with as much passionate conviction from the judicial personages hearing them as that of their champions, could not be more aptly invoked than in respect of the case of *CIR v Ocean Manufacturing Ltd*⁷³. In that case the taxpayer company was forbidden from setting off its assessed loss essentially, in my view, on the basis that one integral agreement was contained in two separate documents. The taxpayer was a wholly-owned subsidiary of a public company that was in financial ruins and in danger of liquidation. The public company rescued itself from the unforgiving flames of bankruptcy, by concluding a scheme of arrangement with its creditors in terms of s 311 of the Companies Act⁷⁴ which duly received the Supreme Court's sanction. This move, however, was not enough to save it from a possible delisting of its shares from the Johannesburg Stock Exchange. To get around that problem, the public company concluded a merger agreement in October 1980 with a separate company ("O") in terms of which agreement O acquired 75% of the shares in the public company and the public company in turn acquired all the issued shares in O, O effectively becoming a wholly-owned subsidiary of the public company.

⁷³ 1990 (3) SA 610 (A)

⁷⁴ Act 61 of 1973

Provision was made in the merger agreement for the sale, at a later date, of O's business as a going concern to MH, another wholly-owned subsidiary of the public company. MH had a substantial assessed loss. The transfer agreement was concluded in July 1981 between O and MH. Both the Special Income Tax court and the Provincial Division⁷⁵ found for the taxpayer on the basis that both the merger agreement and the transfer agreement comprised a complete package, and that the transfer agreement was "an integral, indeed an essential component of the package".⁷⁶ The Special Court went on to hold that the whole structure of the package was interdependent, and that each component was necessary for the cohesion and success of the whole.⁷⁷

The Appellate Division, however, thought otherwise. The court construed the two agreements as separate agreements with different parties. It then concentrated its attention on the transfer agreement and found that the sole or main purpose for its conclusion was to utilise MH's assessed loss.

It is respectfully submitted that the Appellate Division was correct not only in its conclusion but also in its reasoning. On the facts of this case an argument, such as was offered for the taxpayer, that two agreements are in fact one is hardly convincing. In my view, that the court would probably have decided otherwise had the two agreements been

⁷⁵ It appears that neither judgment is reported.

⁷⁶ See 616B-D of the AD judgment.

⁷⁷ *Ibidem*

contained in one document is borne out by the following dictum⁷⁸:

On the facts there is no basis for the submission that there was here, effectively and from an economic and business point of view, only one transaction. Although it is correct that the transfer agreement would not have been entered into but for the merger agreement, the fact is that they were discrete transactions, and the transfer agreement, although contemplated by clause 11 [of the merger agreement], was in no way a component of the merger agreement.

The conclusion is that what has to be considered is the purpose of the parties to the transfer agreement in entering into that agreement. It could not be disputed that the sole purpose was to utilise the assessed loss of [MH] to avoid liability for tax... . There could be no other purpose.

In the *Conshu*⁷⁹ case the Appellate Division was divided on the proper construction of s 103(2). The question before the court was whether the Commissioner, not having applied the provisions of s 103(2) during the year of assessment in which an agreement was concluded admittedly solely or mainly for the purpose of utilising an assessed loss, was entitled to invoke the subsection in respect of a subsequent year.

The material facts of that case, which were common cause between the parties, can be stated briefly as follows: The taxpayer, Conshu (Pty) Ltd, a tyre retreader and dealer was experiencing poor trading results and had a large assessed loss towards the end of its 1985 tax year. Pressure from its bankers forced it to take drastic measures such as effecting a

⁷⁸ At 618

⁷⁹ Supra

name change⁸⁰, effecting a change in shareholding, acquiring all the trading assets and liabilities of another company (United-Fram) on the very last day of the taxpayer's tax year (30 June 1985) and disposing of a substantial part of its business excepting its solid tyre business.

In its 1986 tax year the taxpayer derived a not insignificant income and sought to set off its 1985 assessed loss against it. The Commissioner obliged. Two years later, however, the Commissioner, not known for a philanthropic disposition of any magnitude, struck back and disallowed such income as he was satisfied had arisen as a direct result of the acquisition of United-Fram's business. He allowed only that portion of the income which was produced by the taxpayer's solid tyre business. That income was, of course, not so significant. The effect of this re-assessment was that instead of having a balance of assessed loss of some R4m, the taxpayer emerged with a taxable income of almost R7m with which result it was not particularly pleased. The Commissioner's reason for disallowing set-off of the 1985 assessed loss against the whole of the 1986 tax year income⁸¹ was that a large portion of that income was derived as a direct result of the acquisition of United-Fram's business which acquisition was effected solely or mainly for purposes of utilising the 1985 assessed loss and so was irretrievably lost to the taxpayer by operation of s 103(2). The taxpayer's objection was based on the submission that the Commissioner should have applied the provisions of

⁸⁰ The taxpayer was formerly known as National Tyre Co (Pty) Ltd.

⁸¹ Set-off was allowed only against the income produced by the solid tyre business of which the taxpayer had not disposed when it sold a bulk of its business.

s 103(2) in respect of the year during which the United-Fram agreement was concluded and effected (ie. the year ended 30 June 1985) and that, inasmuch as he failed to do so, he was not entitled to invoke the subsection for the first time in respect of the 1986 tax year. Of course, the Commissioner disallowed the objection on the ground that he was entitled to apply the subsection for the first time in respect of 1986 notwithstanding that the agreement that fell foul of the subsection had been concluded in 1985. The Special Court agreed with the Commissioner and the taxpayer appealed directly to the Appellate Division.

In delivering the majority judgment of the Appellate Division, Harms JA said that on the plain wording of s 103(2) the Commissioner was entitled to apply the subsection long after the date on which the Act came into operation (ie after 1 July 1962) to an agreement concluded before that date. In other words, the Commissioner is entitled to apply the subsection in, say, June 1964 to an agreement entered into in November 1961 (provided, of course, that such agreement was entered into solely or mainly for the purpose of utilising assessed loss). His Lordship then continued to express his difficulty in understanding why, if the Commissioner is, on the plain wording of the section, entitled to apply it after the coming into operation of the Act to an agreement concluded before that date, he is not entitled to invoke it in 1986 in respect of an agreement concluded in the previous year. His Lordship then said:⁸²

⁸² At 93

[T]he subsection states that *at whatever time* the Commissioner is satisfied that *any agreement has at any time been effected* [solely or mainly for utilising assessed loss], he may disallow the attempted set-off. The provision is replete with the indefinite 'any' ... [and] ... there is nothing in the provision to suggest that the word 'any' was used in a limited sense. (My italics)

His Lordship then concluded that the Commissioner was entitled to apply the subsection for the first time in 1986 in respect of the 1985 agreement⁸³.

Harms JA held further that the Commissioner had had no occasion to disallow the set-off of any assessed loss in 1985 because the taxpayer had not attempted any set-off during that year. The Commissioner could apply the subsection only in reaction to an attempted set-off and could not anticipate set-off by seeking a declaratory order. Bearing this in mind, to then hold, as the taxpayer sought the court to do, that inasmuch as the Commissioner had failed to apply the subsection in 1985 he could not do so in respect of the 1986 year would be destructive of the purpose of the provision. On this point, his Lordship then said:⁸⁴

It would also allow for the evasion of the provision. It must, from a commercial point of view, be simple to structure a deal in such a manner that the change in shareholding is effected in year 1 and to have the company receive income as a result of it in year 2 or 3 whilst the assessed loss is kept alive by some or other insignificant untainted trade.

EM Grosskopf JA did not concur with his Brother's interpretation of the subsection.

His Lordship was of the view that s 103(2) "can be applied only to the assessed loss existing

⁸³ In fact, more accurately, the Commissioner applied the section in 1988 to the 1986 income tax return in respect of the 1985 agreement. The income derived as a result of the 1985 agreement was obviously reflected in the 1986 tax return which was the year in which the set-off was claimed and the Commissioner applied the subsection to that return in 1988.

⁸⁴ At 94

in the year in which the [agreement entered into for the sole or main purpose of utilising assessed losses] is concluded and takes effect", and that it cannot be applied to an assessed loss that arises in a subsequent year.⁸⁵ Having quoted the subsection in its entirety, his Lordship then concluded that for a set-off or balance of assessed loss to be disallowed for the purposes of the subsection, two requirements must be met:

1. **As a direct or indirect result of the relevant agreement income must have been received by or accrued to the company *during any year of assessment.***
And:
2. **The Commissioner must be satisfied that the relevant agreement was entered into or effected solely or mainly for the purpose of utilising any assessed loss or any balance of assessed loss incurred by the company in order to avoid liability for the payment of any tax. (My italics)⁸⁶**

His Lordship then considered and dismissed the significance that Harms JA accorded use of the words "any" and "whenever" in the subsection. Regarding use of "any" his Lordship said that a repetitive use of that word cannot alter the fact that there can only be one assessed loss at any one time. He then dismissed use of "whenever" at the very beginning of the subsection as having "no connotation of time".⁸⁷

It is respectfully submitted that the majority judgment on the proper construction of s 103(2) is preferable to the minority judgment. While there is nothing in the subsection to

⁸⁵ At 97

⁸⁶ At 96

⁸⁷ At 99

suggest that the words "whenever" and "any" are used in the limited sense suggested by EM Grosskopf JA, there is, in my view, every indication that the Commissioner is entitled to invoke the subsection at any time a set-off is claimed and to any assessed loss against which such set-off is claimed. As Harms JA points out⁸⁸, if the minority's construction of the subsection were correct, its circumvention would be easily attainable by simply structuring an agreement in such a manner that its resultant income accrues or is received in a later year while the assessed loss is kept alive by some insignificant untainted trade. In that event the Commissioner would be unable to invoke the section during the year of the agreement because the untainted trade whence the income arises against which the assessed loss is set-off has no link with the agreement whatever. Similarly, he would be precluded from applying the subsection in the year in which the income directly resulting from the agreement accrues or is received on the ground that he failed to apply the subsection during the year of the agreement. That, with respect, would be an absurd result that could not have been intended by the legislature. It is submitted that it is precisely this sort of mischief against which the subsection is aimed and it should therefore rather be construed in a manner that advances the remedy it provides and suppresses the mischief against which it is directed than in a manner that restricts the Commissioner's discretion by interpretation.⁸⁹

3.1.4 compromise with creditors: s 311 of the Companies Act 61 of 1973

In addition to the three requirements discussed above, the Act imposes two

⁸⁸ At 94

⁸⁹ See *Glen Anil Development Corporation Ltd v SIR* 1975 (4) SA 715 (A) at 727H - 728A.

further restrictions on the set-off of assessed losses against a company's income, the first of which being that a company may not carry forward to the next year any assessed loss incurred prior to the date of its final liquidation for set-off against income received after that date, unless the final order of liquidation has subsequently been set aside.⁹⁰ The dearth in reported case law on this provision of the Act is perhaps an indication of the straightforwardness thereof. The second restriction is perhaps not so straightforward as the Appellate Division has had occasion to pronounce thereon. The provision⁹¹ says that for purposes of determining any person's taxable income there shall be set off against the income derived by such person:

any balance of assessed loss incurred by the taxpayer in any previous year which has been carried forward from the preceding year of assessment: Provided that -
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. (My italics)

In *CIR v Louis Zinn Organisation (Pty) Ltd*⁹² the court was called upon to pronounce on the application of s 11(3)(a)(ii) of Act 31 of 1941 (an equivalent provision to s 20(1)(a)(ii) of Act 58 of 1962). The material facts are that the taxpayer incurred a trading loss of 105 401 pounds in year 1. In the same year, the taxpayer showed a gain of 93 755 pounds

⁹⁰ s 20(1)(a)(i). See 5 above for an example of how this may arise in practice.

⁹¹ s 20(1)(a)(ii)

⁹² 1958 (4) SA 477 (A)

arising out of a compromise with its trade creditors. In determining the taxpayer's assessed loss for that year, the Commissioner deducted the said sum of 93 755 pounds from the trading loss (ie the current year's loss) of 105 401 pounds to arrive at an assessed loss of 11 646 pounds. The taxpayer objected *inter alia* on the ground that the loss of 105 401 pounds should not have been reduced by the sum of 93 755 pounds as the latter amount was a benefit which accrued to the taxpayer in the same year as that in which the loss, a current year's loss, was incurred. The loss which was reduced was not a balance of assessed loss carried forward from the previous year and therefore [s 20(1)(a)(ii)], it was contended by the taxpayer, had no application. The taxpayer's objection having been disallowed, its appeal to the Special Court was upheld on the ground that, on a proper construction of [s 20(1)(a)(ii)], it was only an assessed loss brought forward from a previous year which fell to be reduced by a benefit of this nature, not a current year's assessed loss, and that the Commissioner had accordingly erred in reducing the assessed loss incurred in the current year of assessment. On appeal by the Commissioner to the Appellate Division the court held that the reduction of the 'balance of assessed loss' referred to in [s 20(1)(a)(ii)] takes place at the stage when the balance is determined for use in the future. In other words, the court held, the balance of assessed loss referred to in the subsection refers to the balance determined at the end of the year of assessment. The court accordingly ruled that the Commissioner had correctly deducted the amount of 93 755 sterling pound from the loss of 105 401 pounds and determined the balance of the assessed loss as being 11 646 pounds.

It is respectfully submitted that neither s 11(3)(a)(ii) of Act 31 of 1941 (which is

identical to s 20(1)(a)(ii) of the 1962 Act in all material respects) nor s 20(1)(a)(ii) of Act 58 of 1962 is capable of the construction given it by the Appellate Division in the *Louis Zinn* case. Both provisions clearly provide that it is the balance of assessed loss incurred in any previous year and carried forward from the preceding year that falls to be reduced by the amount or value of any benefit received by or accruing to the taxpayer as a result of a compromise with creditors. Thus, it would appear that both provisions contemplate a benefit that is received by or accrues to the taxpayer in a year subsequent to that in which an assessed loss is incurred. What is more, the words "*balance of assessed loss*" cannot, with respect on a proper construction of the subsection, refer to anything other than assessed loss incurred in any previous year and which has been carried forward from the preceding year. A current year's assessed loss is referred to as "assessed loss" and not "balance of assessed loss".⁹³

A lesson that could perhaps be learned from the *Louis Zinn* judgment is that sometimes even a most accomplished judge can fall prey to a mild loss of cognition, and that on such occasions one can do no more than pray that such loss is favourable to one's own case.

Subsequent to *Louis Zinn* a number of other courts were seized with the application of s 20(1)(a)(ii) -- or its equivalent -- albeit not the subject matter with which the court in

⁹³ Emslie, Davis & Hutton *Income Tax: Cases & Materials* (2nd Edition) 827.

Louis Zinn was seized.⁹⁴ *Blue Moon Investments (Pvt) Ltd v COT*⁹⁵ is authority for the proposition that the subsection is applicable not only where a compromise is effected with each and every creditor but also where it is concluded with some of the creditors. In *Case No 8553*⁹⁶ the proposition was extended further when it was held that the subsection is also applicable where a compromise has been made with a single creditor.

3.2 Taxpayers other than Companies

Neither the earning of income (whether in its defined sense or otherwise) nor the carrying on of a trade is a requirement for taxpayers other than companies for purposes of set-off of assessed losses.⁹⁷ However, both the restrictions pertaining to sequestration and compromise contained in s 20(1)(a)(i) and (ii), respectively, are applicable.

From the non requirement of income in respect of taxpayers other than companies, a question that arises is whether a non-company taxpayer may set off a trade assessed loss against non-trade income and vice versa. There appears to be nothing in the Act that forbids

⁹⁴ Although Schreiner ACJ, as he then was, was clearly wrong in his interpretation of the subsection there under consideration (and I say this with great deference to a truly great judge), no taxpayer has seen fit to brave the Appellate Division with a test case on the subject. Thus, whatever its demerits, Schreiner ACJ's judgment is the law inasmuch as his is the latest Appellate Division pronouncement on the subject.

⁹⁵ 1966 (4) SA 205 (RAD)

⁹⁶ Unreported Special Court judgment of Melamet J delivered on 21 November 1988.

⁹⁷ s 20(2A)

such a possibility. The point was raised in respect of a company in *ITC 777*⁹⁸ but, although the court inclined to the negative view (ie that a trade assessed loss cannot be set off against non-trade income), the court found it unnecessary to express a definite opinion on the point. In my view, because neither income nor trade is a requirement for non-company taxpayers to effect a set-off, it would seem inconsequential from whence income or assessed loss originates. In respect of companies, however, there would appear to be a fairly sound basis for the proposition that any income arising from dealings that fall outside the scope of the company's objects clause cannot be taken into consideration in effecting a set-off for a retail company may, on realising that it has not actually traded for almost the entire year, seek to utilise its assessed loss by selling some of its shares on the last day of its tax year and then seeking to set off its assessed loss against the income derived from such sale. It is submitted that such an eventuality would be contrary to the scheme of the Act.

4. GROUP TAXATION

In Chapter 10 of its *Third Interim Report of the Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa*, the Katz Commission deals with group income taxation and proposes a gradual introduction thereof in South Africa. The Commission's point of departure is that, in regarding each individual company within a group as a separate taxpayer, "South Africa is out of step with the tax treatment of companies in most industrialised economies".⁹⁹ In this part of the paper I propose giving a brief outline of the

⁹⁸ 19 SATC 320

⁹⁹ para 10.1.1 of the Report

advantages and disadvantages of the group basis of company taxation for purposes of the utilisation of assessed losses, and then hazard my personal view on the subject based on a brief and objective analysis of both some of the arguments in favour of group taxation, on the one hand, and arguments against its implementation on the other. However, before embarking on some analysis of company group taxation it behoves me perhaps to "unpack" the term "group taxation" and then briefly discuss the two best known systems of group taxation.

The term "group taxation implies -

the taxation of a group of consolidated or related companies as if it were a single unit. A proper descriptive term would be "group taxation on a consolidated basis".¹⁰⁰

The two best known group taxation systems are the loss transfer system and the consolidated system. The loss transfer system, operative in the United Kingdom, envisages a system where a group, within which each company is to some extent commonly owned, may elect to transfer any new assessed loss from any one company within the group to any other within the group within two years before the end of its tax year. There is no requirement for payment of some consideration for the loss transfer by the recipient company. Where any consideration is made therefor, the transaction does not give rise to any adverse tax implications. The consolidation system is operative in the United States of America and in

¹⁰⁰ *Report of the Commission of Inquiry into the Tax Structure of the Republic of South Africa (1986)*("the Margo Commission") para 10.101

much of continental Europe. The manner of its operation is that the tax of each company in the group is computed in the normal manner and then consolidated with that of other companies in the group. Inter company profits and losses within the group are reversed. Current assessed losses are aggregated and set off against aggregate consolidated income. Assessed losses carried forward by a company within the group from a period when such company was part of the group may be set off against group profits. However, where such company carried forward an assessed loss from a period when it was not part of the group and so was separately assessed, set-off of such assessed loss may only be effected against the income arising in a period when the company is again separately assessed. This restriction serves to curb abuse of the system by acquisition by the group of a company with an existing assessed loss, the very mischief against which s 103(2) is targeted.

Of these two systems the Katz Commission suggests that the consolidation system is preferable to the loss transfer system.¹⁰¹ Some of the stated grounds on which the Commission makes that suggestion are that, first, the loss transfer system does not recognise the economic unity of a group. Secondly, the loss transfer approach is inherently complex in that the tax status of each company within a group can seldom be stated with certainty at the end of the tax year or even some years later. What is more, in light of the time period allowed within which to elect whether or not to transfer a new loss from one company to another within the group, particularly in view of the permutations and combinations that arise, forecasting future income or profits and making the correct choice requires immense

¹⁰¹ Para 10.3 of the Report

skill.

Thirdly, the Commission maintains, under the consolidation approach the recognition of real economic interests serves to limit manipulations aimed at tax avoidance, thus protecting the interests of the fiscus. Fourthly, the consolidation system has the advantage of the entire group's trade results being presented to the Commissioner in a single submission. This facilitates an easy audit trail and solves the problem of the availability of information for various companies in a haphazard manner where companies in a group are separately assessed.

The fifth ground on which the Katz Commission prefers the consolidation system of company group taxation is that, while there is potential for manipulation of intra-group transactions under the loss transfer system -- for example the engineering of timing differences, manipulation of cost bases and exploitation of capital/revenue mismatches -- which is facilitated by treatment of companies within a group as separate taxpayers, such manipulation under the consolidation system loses its impact in that the group is taxed as a single entity, and where the tax impact of such manipulation still looms large the conflicting economic interests of companies outside the group will often be an effective disincentive.

It is submitted, and for the reasons stated immediately above, that if any company group taxation system were envisaged for South Africa, the consolidation system would be preferable. I now propose considering in turn some of the arguments against and the

arguments in favour of the introduction of a company group taxation on a consolidated basis in South Africa.

4.1 Arguments against¹⁰²

Some of the arguments raised by opponents of group taxation are¹⁰³:

1. that there would be a significant loss of revenue to the fiscus;
2. that there would be an abuse of limited liability in that separate companies within a group would enjoy limited liability without the concomitant tax disadvantages of locking in tax losses;
3. that group taxation on a consolidated basis would undermine the basic principle that separate legal entities are taxed separately;
4. that there would arise tax manoeuvres in an attempt to transfer loss-making companies into a group for tax relief purposes, and this would necessitate complex anti-tax avoidance measures;
5. that group taxation of companies is an ostensibly complex system of taxation;
6. that the group taxation system where each of the companies in the group is wholly owned by the group would provide an incentive for the group holding company to squeeze out minorities in order to achieve the 100% level of ownership, and that this would lead to a concentration of the economy in a few hands which phenomenon is

¹⁰² See para 10.105 of the Margo Commission Report.

¹⁰³ I enumerate only those disadvantages that I consider still relevant to the debate.

not in the public interest.

4.2 Arguments In Favour¹⁰⁴

Arguments in favour of group taxation of companies include the following:

1. that it is unfair for a group which earns profits through one subsidiary and incurs losses of a similar amount through another to have to pay tax, while the group considered as an economic entity has only managed to break even or even incurred losses;
2. that the absence of group taxation is somewhat of a disincentive to international investment in South Africa;
3. that by introducing group taxation South Africa would fall in step with many industrialised economies with which it trades and thereby facilitate more international trade and investment in the country;
4. that the absence of group taxation on a consolidated basis implies an impetus towards large divisionalised companies.

4.3 View Based on Analysis of Contra and Pro Arguments

The Margo Commission was persuaded by the arguments against group taxation and came out, by majority vote, against recommending a move towards group taxation. On the other hand, the Katz Commission has recommended a gradual approach towards a group

¹⁰⁴ See para 10.106 of the Margo Commission Report.

taxation system of the consolidation type. The reason for the gradual approach is that the Commission recognises the validity of at least two arguments against group taxation¹⁰⁵ which could cause difficulties in the implementation of a group taxation system -- the perceived loss to the fiscus and complexity of the system.

While it has found that claims of potentially substantial losses to the fiscus are largely exaggerated or unsubstantiated, the Katz Commission recommends that these potential losses to the fiscus can be largely eliminated by excluding losses accumulated prior to the first consolidation.¹⁰⁶ What is more, the Commission avers, the fiscus suffers substantial losses from the current system which fails to detect and control artificial transactions between companies with a shared economic interest.¹⁰⁷ Regarding the complexity argument, the Commission considers that a compromise with a pure consolidation system in three particular areas would address most of the problems of complexity.¹⁰⁸ These areas are that, first, the group should initially be defined as wholly owned by a holding company. Secondly, only the assessed losses incurred during the year of assessment in which consolidation takes place should be set off and those incurred prior to the introduction of the system or prior to a company becoming part of the group should be excluded. This, in the Commission's view, eliminates the complexity of having to keep track of various generations of losses for

¹⁰⁵ The Commission considers that some of the other arguments either had doubtful validity or have fallen away. See para 10.2.9 of the Katz Commission Report.

¹⁰⁶ para 10.4.2 of the Katz Commission Report.

¹⁰⁷ para 10.4.4 of the Katz Commission Report.

¹⁰⁸ para 10.4.7 of the Katz Commission Report.

consolidation purposes. Thirdly, a full consolidation need not be made in the initial stages of the system until both the authorities and taxpayers have become familiar with the system. Some of the special allowances which the Commission considers should be excluded are the credit agreements and debtor allowances (s 24) and the allowances in respect of future expenditure on contracts (s 24C).

In my view, the consolidation group taxation system would limit opportunities for the creation of economic and business distortions purely for income tax purposes. A single economic unit comprising various companies with common business and economic interests for purposes of strategic management and financial planning is a reality which should not be penalised by an adverse tax system such as South Africa currently has. It is unfair and a distortion of the reality for a group that makes a profit through one wholly owned subsidiary and a greater loss through another to have to pay tax while the owner makes a loss overall. What is more, inasmuch as South Africa is now fully participating in international trade and investment, and its major trading partners have a group taxation system of one form or another, it is necessary to review the basis of our company taxation. In a word, therefore, the arguments in favour of the introduction of group taxation of the consolidation type in South Africa are, in my view, rather more compelling than those against its introduction.

5. CONCLUSION

In this paper I have sought to explore and, in the process, challenge some of the conventional wisdom on the utilisation of assessed losses for purposes of reducing the

taxpayer's tax bill. I have also sought to highlight some of the lessons, gleaned from reported judgments, that taxpayers could learn from the folly of others' aborted ingenuity, if only to seem much the wiser in our position of armchair critics. Much emphasis has been primarily on the construction of s 20 (particularly in respect of companies) and, secondarily, s 103(2) of Act 58 of 1962 so that the discussion on group taxation and its effects on the utilisation of companies' assessed losses has been embarked upon for the sake of completeness.

It is apparent, in my view, that the time for the introduction of group taxation in the South African Income Tax Act has arrived. It appears further from the arguments raised in this paper that s 20 of the Act should be revisited so that there is no uncertainty about the income requirement and the context in which the word "income" is used in that section, particularly in light of the obiter statements in the *Conshu* case. What is more, the section requires amendment in respect of the provision pertaining to the reduction of assessed losses by the amount or value of any benefit received by or accruing to a taxpayer as a result of a concession granted or compromise made with creditors, particularly in light of the judgment of Schreiner ACJ (as he then was) in *Louis Zinn* to the effect that a taxpayer's assessed loss can be reduced by the amount of a s 311 compromise entered into in the same year of assessment.

It is my respectful view that s 103(2) clearly allows the Commissioner to invoke the section at any time a set-off is claimed and to any assessed loss in respect of which such set-

off is claimed irrespective of when the transaction giving rise to the income against which the set-off is claimed is concluded, provided that the Commissioner is satisfied that the sole or main purpose of such transaction was to utilize the assessed loss or balance of assessed loss. There is, with respect, nothing in the section to suggest that it can be applied only during the year in which the "tainted" transaction is concluded. Indeed, such a construction of the section would render the provision easily circumventable by simply claiming a set-off not in the year of the "tainted" transaction but in a later year. South Africa would, as a result, certainly attract a lot of foreign investment but at great cost to the fiscus.

Be that as it may, perhaps the section ought to be amended to put it beyond doubt (if the construction of the majority in the *Conshu* case with which I, with respect, agree were correct) that the section can be applied at any time a set-off is claimed and to any assessed loss in respect of which such set-off is claimed regardless of whether the "tainted" transaction is concluded in the year of set-off or in a subsequent year. If the Appellate Division can be so starkly divided on the proper construction of a provision, then it is my view that a challenge has thereby been laid before the legislature to put matters beyond doubt -- expeditiously.

Finally, perhaps I ought to mention that soon after the Special Income Tax court decision in the *Conshu* case the Commissioner issued a Practice Note¹⁰⁹ to the effect that concern had been expressed that, because of the opening words of sections 103(1) and

¹⁰⁹ No 20 dated 25 June 1993

103(2), it appears that the Commissioner could re-open any assessment regardless of the time period that has expired since the original assessment date. The Commissioner then clarified the position by saying that the raising of additional assessments in terms of these sections (and in terms of s 103(5)(a)) is subject to the provisions of s 79 of the Act. Effectively, therefore, additional assessments may not be raised after the expiry of three years from the date of the assessment unless the Commissioner is satisfied that the amount which should have been assessed to tax was not so assessed or the fact that the full amount of tax chargeable was not assessed, was due to fraud, misrepresentation or non-disclosure of material facts. The Katz Commission¹¹⁰ then recommended that s 103(2) of the Act be amended to embody the provisions of the Practice Note. With respect, I agree with the Commission.

¹¹⁰ at para. 11.7.4

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