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PRACTICE MAKES IMPERFECT

A DISCUSSION OF REVENUE PRACTICE NOTE 24

AND RELATED ISSUES

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Revenue Practice Note 24 dated 8 August 1994 reads as follows:

> "Self-employed taxpayers must claim their motor vehicle expenses based on the actual cost incurred in respect of such vehicle over the actual distance travelled. The private use of the vehicle must, therefore, be based on actual figures.
>
> To reduce the workload for both taxpayers and Inland Revenue, it is acceptable in cases where a taxpayer has not maintained adequate records, to base the private use of the vehicle on the value determined in terms of paragraph 7(4) of the Seventh Schedule to the Income Tax Act."

Paragraph 7(4) of the Seventh Schedule to the Income Tax Act, 58 of 1962, as amended, ("the Act") provides that employees are to be taxed on a value of 1,8 per cent per month of the "determined value" of a motor vehicle, the use of which is granted to them by virtue of their employment. The determined value of a vehicle is its cost excluding finance charges and VAT, and the amount obtained by multiplying this cash cost exclusive of VAT by 1,8 per cent per month is reduced by R120 per month where the employee bears the cost of all fuel used for the purposes of the private use of the vehicle, and by a further R85 per month where the employee bears the full cost of maintaining the vehicle (including the cost of repairs, servicing, lubrication and tyres).

Thus if a motor vehicle costs R100 000 exclusive of finance charges, interest or VAT, the employee would have to include R1 800 per month in gross income, which is R21 600 per annum, less R2 460 for a full year where the employee bears the cost of fuel and maintenance, leaving a taxable amount of R19 140 per annum.

The effect of Practice Note 24 is that a "self-employed" person (a contradiction in terms, which perhaps mirrors the muddled thinking underlying the practice note) should claim all the deductible expenses associated with running his or her motor vehicle, and then add back an amount equal to the notional fringe benefit of the use of such motor vehicle.

The first and most basic problem with this practice is that there is absolutely no authority for it in the Act.

The relevant provisions of the Act, ie the general deduction formula and s 11(*e*) would, it is submitted, require and permit one to claim travelling expenses to the extent to which one's motor vehicle is used for the purposes of trade. Travelling expenses typically claimable would be: finance charges, wear and tear (or rent where the vehicle is leased), insurance, petrol, maintenance, repairs, etc. All these items, with the exception of the wear and tear allowance, represent "expenditures" and, if the motor vehicle is used for trade purposes, would be deductible to the extent to which the motor vehicle is so used. In the case of the wear and tear allowance, it is submitted that the reasoning of Botha JA in **Solaglass Finance Co (Pty) Ltd v Commissioner for Inland Revenue 1991 (2) SA 257 (A) at 278B-280G**, in relation to a loss as

opposed to an expenditure, would by a parity of reasoning apply to an allowance such as the wear and tear allowance.

In the **Solaglass case**, the taxpayer had claimed a loss incurred in respect of a loan becoming irrecoverable, and in the context of s 23(*g*), which then provided that no deduction could be obtained in respect of:

> "any moneys, claimed as a deduction from income derived from trade, which [were] not wholly or exclusively laid out or expended for the purposes of trade",

it was argued on behalf of the taxpayer that a loss did not represent "moneys laid out or expended", and that s 23(*g*) therefore did not apply to losses claimed as a deduction from income. Botha JA rejected this argument, with respect correctly, in the following terms:

> **"Section 23(*g*) does not refer to in terms to 'losses', as does s 11(*a*). Counsel for the appellant based an argument on the difference, in this respect, between the two sections. He said that it showed that the Legislature did not intend s 23(*g*) to apply to the deduction of 'losses' at all; and, since the appellant was clearly claiming a deduction of 'losses', and nothing else, its claim could not be barred by s 23(*g*). I do not agree. It seems to me that the argument does violence to the plain meaning and effect of the language used in s 23(*g*), particularly when it is contrasted with the wording of s 11(*a*), and more especially when it is considered in the context of the other paragraphs of section 23, as I shall now endeavour to show."**

After citing the provisions of s 23(*g*), Botha JA continued as follows at 278E:

"The prohibition is of wide ambit. This can be seen when that against which the prohibition is dissected into its component parts, as follows:

(i) deductions
(ii) in respect of
(iii) any moneys
(iv) claimed as a deduction from income derived from trade
(v) which are not wholly or exclusively laid out or expended for the purposes of trade.

The core of the prohibition is to be found in (iii): 'any moneys'. That expression in itself is not concerned with 'losses', either inclusively or exclusively; it is entirely neutral in relation to the concept of 'losses'. So is the wording of (v), which is the substance of the prohibition. Re-casting it in positive terms, the requirement is that any moneys sought to be deducted must be moneys which are laid out or expended in the manner specified. The requirement comprises two component notions: (a) moneys which are laid out or expended; and (b) in a particular manner, ie wholly and exclusively for the purposes of trade. But the requirement in no way touches upon the question whether moneys which are laid out or expended are decreed not to be deductible if they are not laid out or expended in the manner required. There is nothing in the section to support the argument that the prohibition does not apply when moneys which are laid out or expended happen to result in losses.

I turn to s 11(*a*). Insofar as it is relevant for present purposes, its ingredients may be stated as follows:

(i) there shall be allowed as deductions from the income
(ii) expenditure and losses
(iii) actually incurred
(iv) in the production of income
(v) provided such expenditure and losses are not of a capital nature.

The pivot of the provision lies in (ii): 'expenditure and losses'. This expression characterises the nature of that which is authorised to be deducted. Consequently, in applying the section, it may be necessary to consider the distinction between 'expenditure' and 'losses' and the contrasting concepts of voluntary payments and involuntary deprivations (cf *Joffe & Co Ltd v Commissioner for Inland Revenue* 1946 AD 157 at 166-7), and such consideration may be important when it comes to applying the proviso in (v), where the issue is whether or not the expenditure, or the losses, are of a capital nature (see *Stone v Secretary for Inland Revenue* 1974 (3) SA 584 (A) at 593E-594H, and *Burman v Commissioner for Inland Revenue* 1991 (1) SA 533 (A)). So, in the case of a loan which has become irrecoverable, the amount of which is sought to be deducted, important considerations are that it is not the 'expenditure' incurred in advancing the loan which is sought to be deducted, but the loss of the loan capital by reason of its having become irrecoverable; and

in that regard, for the purposes of applying the section, it is relevant to observe that were it not for the loss of the loan capital there would be no question of any deduction and that the real issue in such a case is the deductibility of the loss (see *Stone's* case *supra* at 593E-F). But in my view considerations such as these are confined to the context of s 11(*a*); they have no bearing on the application of s 23(*g*). Section 11(*a*) provides positively for what may be deducted, and s 23(g) negatively for what may not, but there is no direct correlation between the one and the other. So, for instance, the question whether or not expenditure is of a capital nature is vital to the enquiry under s 11(*a*), but it plays no role in the application of s 23(*g*). The enquiries under the two sections are notionally and logically discrete. That this is so is demonstrated by the fact that the Legislature did not transpose the descriptive expression 'expenditure and losses' from s 11(*a*) to s 23(*g*); instead, it used in the latter section the colourless expression 'any moneys'. Section 11(*a*) is concerned with the deduction of 'expenditure' *qua* expenditure and the deduction of 'losses' *qua* losses, while s 23(*g*) focuses on the deduction of 'moneys' *qua* moneys. And 'moneys ... laid out or expended' do not become the less so because they are lost.

The impact of the difference in phraseology that I have mentioned becomes even clearer when regard is had to the setting of para (*g*) of s 23 in the section as a whole. Each of the paragraphs (*a*) to (*i*) commences with a statement of the particular matter in respect of which no deduction shall be made. The Legislature's choice of wording is significant:

'(a) the cost incurred ...
(b) domestic or private expenses ...
(c) any loss or expense, the deduction of which would otherwise be allowable ...
(d) the taxation levied ...
(e) income ...
(f) any expenses incurred ...
(g) any moneys claimed as a deduction ...
(h) interest ...
(i) entertainment expenditure ...'.

The differences in the wording speak for themselves: there is no reason for thinking that the Legislature's selection of language in para (*g*) was anything but deliberate and designed.

Applying the views expressed above to the facts of this case, I see the position as follows. The appellant, in taking over or advancing the loans in question, laid out and expended moneys; it incurred expenditure. When the loans became irrecoverable, it incurred losses. The deductions to which the appellant lays claim represent, at one and the same time, the moneys laid out and expended, the expenditure incurred, and the losses incurred. In order to determine whether the deductions claimed are allowable under s 11(*a*), an assessment of the nature of the losses incurred

is called for. That enquiry yields the answer that the losses are deductible under s 11(*a*). We then move on to a different enquiry: whether the losses, found to be deductible under s 11(*a*), are disqualified from deduction by virtue of s 23(*g*). For the purposes of this enquiry, the nature of the losses, *qua* losses, is no longer of any consequence. What is important, viewed through the framework of s 23(*g*), is the characteristic of the losses as constituting, as a matter of fact, 'moneys claimed as a deduction from income derived from trade'. There is no doubt that the losses fall squarely within the ambit of these words. Nor can there be any doubt that the 'losses', in their new garb of 'moneys claimed as a deduction', were again as a matter of fact 'laid out or expended' by the appellant. In consequence, for the deductions claimed by the appellant to pass the test of s 23(*g*), it must be shown that the amounts of the loans made by the appellant were wholly and exclusively laid out or expended for the purposes of trade."

Botha JA then went on to consider whether, on the facts, the amounts of the loans had been wholly and exclusively laid out or expended for the purposes of trade.

What was recognised in the above *dictum* of Botha JA is the fact that the loss subsequently claimed as a deduction flowed from an earlier laying out or expending of moneys, and that the question whether the moneys had been laid out or expended wholly and exclusively for the purposes of trade had to be determined with reference to the purpose of the taxpayer at the time when the earlier laying out or expending of moneys took place. It is submitted, with respect, that the above comments of Botha JA are correct. In any event, they embody the pronouncement of the majority decision of the highest court in the land, and they moreover form part of the *ratio* of the judgment. As such they must be accepted as the law, whether or not we find ourselves in agreement with them.

Now it is of course true that s 23(*g*) was amended after the **Solaglass** decision, but the amendment does not in any respect rob the above findings of Botha JA of their force. Section 23(*g*) now provides that no deductions shall in any case be made in respect of:

> **"any moneys claimed as a deduction from income derived from trade, to the extent to which such moneys were not laid out or expended for the purposes of trade".**

The effect of the amendment is to permit, and indeed require, an apportionment where moneys have been laid out or expended partly for a trade purpose and partly for a non-trade purpose. But the manner in which one approaches the inquiry has not changed. It has been rendered more difficult because in a case where both trade and non-trade purposes are present one now has to attach weight to such purposes with a view to effecting an apportionment of the moneys laid out or expended, in order to determine how much thereof is deductible; but the approach to the question of the taxpayer's purpose has not changed. One would still have to determine the deductibility of a loss, or the extent thereof, with reference to the taxpayer's purpose or purposes at the time when the moneys were laid out or expended which have subsequently given rise to a loss.

What is the relevance of all this to the question of the deductibility of motor vehicle expenses claimed by so-called self-employed persons? It is that where a motor vehicle has been purchased by a self-employed taxpayer, what will be claimed as a deduction, in addition to expenditure on repairs, maintenance and fuel, etc, is the depreciation or wear and tear allowance provided for in s 11(*e*) of the Act. Section 11(*e*) provides that there shall be allowed as a deduction from income:

> **"... such sum as the Commissioner may think just and reasonable as representing the amount by which the value of any machinery, plant, implements, utensils and articles ... used by the taxpayer for the purpose of his trade has been diminished by reason of wear and tear or depreciation during the year of assessment".**

Although the wear and tear or depreciation allowance is claimable with reference to the diminution of **value** by reason of wear and tear or depreciation, the Commissioner's practice is to ascertain the value with reference to cost where an article has been purchased. It is considered that this practice is in most cases justifiable and correct (cf **ITC 1546 54 SATC 477**).

What is claimable under s 11(*e*), then, is an allowance, being the amount of wear and tear or depreciation determined by the Commissioner as aforesaid, not moneys laid out or expended *per se*. Moneys are laid out or expended when a motor vehicle is purchased, and the amount of wear and tear or depreciation claimable is an allowance determined subsequent to the time when the moneys were laid out or expended, in the same way as a loss resulting from a loan becoming irrecoverable is claimed as a deduction when the moneys previously laid out or expended as a loan are lost. To adapt the language of Botha JA, s 11(*e*) focuses on 'wear and tear or depreciation' *qua* wear and tear or depreciation, while s 23(*g*) focuses on the deduction of 'moneys' *qua* moneys. Thus when one is called upon to determine the amount of a wear and tear allowance which is deductible in terms of s 23(*g*), one is obliged to focus on the moneys laid out or expended at the prior time when money was expended on the purchase price of the article in respect of which the allowance is claimed.

It is submitted that the reasoning of Botha JA in the **Solaglass case** is equally applicable to the case of a wear and tear, or indeed any other, allowance claimable under the provisions of the Income Tax Act pursuant to moneys expended.

The question which arises in the context of the deductibility of motor vehicle expenses where a motor vehicle has been purchased to be used for both business and private purposes, or in income tax language for both trade and non-trade purposes, is this: how does one determine how much wear and tear or depreciation is deductible in terms of s 23(*g*) of the Act as amended?

As already stated, although the wear and tear allowance is not a deduction of moneys laid out or expended *per se*, it does in most cases flow from a prior expenditure of money when the motor vehicle was purchased, and in this sense relates to moneys laid out or expended. If this analysis is not correct, then it would seem that a case could be made for the view that the wear and tear allowance is not subject to the apportionment implicit in s 23(*g*) as amended.

It would appear, then, that a taxpayer who uses a motor vehicle for both trade and non-trade purposes must add all his or her non-capital expenses, plus the wear and tear allowance, and then claim such expenses and allowance to the extent to which the moneys were laid out or expended for the purposes of trade. This is what is required by the Act.

But at what point in time must the extent of the trade and non-trade purposes of the taxpayer be determined? It would seem that, following the analysis of Botha JA, the taxpayer's purposes must be determined at the time when the moneys were laid out or expended.

But ought the taxpayer's purposes be cast in stone at the time when the moneys were expended on the purchase price of the vehicle? What if the actual extent of use for trade purposes varies from time to time, and possibly differs from the taxpayer's purpose when the moneys were actually expended on the acquisition of the vehicle?

It is considered that this problem can be resolved by recognising the fact that in the case of most, if not all, taxpayers acquiring a motor vehicle which is intended to be used for both trade and non-trade purposes, the taxpayer's actual purpose is to use the vehicle for trade purposes as required from time to time, so that the manner in which the vehicle is actually used from time to time is at all times consistent with his or her purpose when the moneys were laid out or expended. It would therefore seem to be justified to determine the extent to which the moneys were laid out or expended for the purposes of trade, as required by s 23(*g*), with reference to the actual extent of trade use in each year of assessment.

Before moving on to discuss how this should be done, it is perhaps necessary to consider the position where a motor vehicle, or for that matter any other article in respect of which wear and tear or depreciation is claimable, is acquired by gift or inheritance, in other words where there is no cost to the taxpayer. Can the analysis of

Botha JA hold in this situation? The thrust of Botha A's reasoning is that although an irrecoverable loan is claimable as a "loss" in terms of s 11(*a*), when it comes to s 23(*g*) it is either deductible, or not deductible, or (we can now add) partly deductible, in the guise of moneys laid out or expended, ie with reference to the taxpayer's purpose when the money was expended in making the loan which gave rise to the loss. But where no moneys were laid out or expended on the acquisition of an article in respect of which the wear and tear or depreciation allowance is potentially claimable, because it was acquired by gift or inheritance, how can the allowance be brought home under the guise of "moneys laid out or expended"? The practice of the Commissioner, correctly we consider in view of the use of the word **value** (as opposed to **cost**) in s 11(*e*), is to determine the amount of wear and tear or depreciation with reference to the market value of the article in question at the time when it was acquired or brought into use by the taxpayer in his or her trade. But the question remains: how is one to apply s 23(*g*) when no moneys were expended or laid out by the taxpayer?

A pragmatic approach, it is submitted, is to recognise that this is an exceptional situation which is not catered for in the Act, and that one should simply deal with the situation as if the taxpayer had in fact expended or laid out moneys on the market value of the article at the time when it was acquired or brought into use. It would indeed be anomalous if s 23(*g*) were not to apply at all simply because the article in question was acquired by gift or inheritance.

What of the situation where a taxpayer incurs an expense and moreover lays out and expends moneys, for example on overseas travel, with the *bona fide* purpose of

spending 80 per cent of the time overseas on business and 20 per cent of the time on holiday? If the time spent on business and on holiday in fact turns out to be 90 per cent and 10 per cent, or 70 per cent and 30 per cent, respectively, ought the apportionment to be based on the taxpayer's purpose when the moneys were laid out and expended, or on what actually transpired? If one adopts Botha A's analysis, the correct answer should be that the taxpayer's purpose when the moneys were laid out and expended should prevail, but one imagines (intuitively perhaps) that in practice what actually transpires is likely to be taken into account.

And should all purposes of the taxpayer necessarily be taken into account, or ought only those which are each legally significant in the sense, perhaps, of being an independent the *sine qua non*, or *causa causans*, of the moneys laid out and expended be taken into account? In the **Solaglass case** Botha JA said the following in the context of expenditure incurred *inter alia* for the purpose of benefitting other group companies (which purpose he considered to be a non-trade purpose) at 284C:

> **"In every case where that occurs, and the question arises whether a particular item of expenditure is hit by s 23(*g*), the answer will have to be found by analysing the particular facts of the case. *Inter alia* one would have to examine the nature of the activities carried on, the nature of the expenditure, and the closeness (or remoteness) of the connection between the expenditure and the benefit derived therefrom by the group. For example, in the present case the appellant presumably incurs ordinary day-to-day expenses in the running of its business, such as paying salaries to its employees, perhaps paying rental for the premises occupied by it, and so forth. There is no doubt that the deduction of such expenses from the appellant's income is not precluded by s 23(*g*). The reason for this is that the connection between such expenditure and the benefit to the group flowing from the appellant's activities is too remote for the latter to qualify as a 'purpose' in terms of the section. But the appellant's expenditure in the form of loans advanced to subsidiaries in the group stands on quite a different footing. Such expenditure is part and parcel, the essential substance, in fact, of the very activities which were designed**

and carried out in order to benefit the group, through the subsidiaries concerned. The connection between this expenditure and the benefit is both direct and immediate. In these particular circumstances the benefit falls within the ambit of the word `purposes' in the section."

(Emphasis supplied.)

This *dictum* of Botha JA suggests that there may be scope for the application of the concept of causation (perhaps the *causa causans* test - see **Stander v Commissioner for Inland Revenue 1997 (3) SA 617 (C) at 624C-D**) in deciding what constitutes a "purpose" in the context of s 23(g) and what does not. Thus only those purposes which **cause** the laying out and expending of moneys, as opposed to those which are merely ancillary or incidental thereto, would constitute "purposes" as contemplated by s 23(*g*). Botha JA's remarks certainly suggest that there may be scope for application of the distinction drawn in **African Life Investment Corporation v Secretary for Inland Revenue 1969 (4) SA 259 (A) at 269-270** between, on the one hand, main and secondary purposes, both of which are legally significant, and, on the other hand, dominant and incidental purposes, where an incidental purpose is subsumed under the dominant purpose and only the absolving dominant purpose is legally significant.

Returning to the question of motor vehicle expenses, how should an apportionment should be made where a motor vehicle is purchased by a taxpayer to be used for both trade and non-trade purposes as circumstances require from time to time?

Let us take the case of an advocate, that most independent, adversarial and argumentative breed of so-called "self-employed" persons, who have no choice but to "trade" as independent professionals. (Of course it is entirely vulgar to regard

advocates as carrying on a "trade", for they are called to the Bar, they do not have clients (the persons they represent being their instructing attorneys' clients), and the fact that they receive anything pecuniary for their services is almost entirely fortuitous. But for income tax purposes they are to be regarded as carrying on a trade as defined in section 1 of the Act.)

Advocates typically bring a motor vehicle to work and park the vehicle in the building where they keep chambers. Travelling from home to the place of one's employment has been held to be private, as opposed to business, travel, so it must be accepted that to the extent that an advocate's motor vehicle is used for conveyance from home to chambers each day, and all too often each night, it is not used for the purposes of trade. But when he or she is required to travel on an inspection *in loco*, or to an out-of-town court, or to a consultation, or even to the Supreme Court of Appeal in Bloemfontein (for fear of flying), such travel clearly constitutes use of the vehicle for the purposes of trade. How then is an apportionment to be made between trade and non-trade use of the motor vehicle for the purposes of s 23(*g*)?

What is clear is that s 23(*g*) itself lays down no basis on which an apportionment is to be made. In the absence of any statutory guideline, it behoves us to see what guidance can be obtained from the cases.

In **Secretary for Inland Revenue versus Guardian Assurance Holdings (SA) Ltd 1976 (4) SA 522 (A) at 535**, Muller JA said the following in the context of allowing an apportionment claimed by the taxpayer as between capital and revenue expenditure:

> **"*Prima facie* the method of apportionment applied by the respondent appears to me to be sensible and clear. But, even if I were to be wrong in holding that view, there could be other possible methods by which a logical and fair apportionment could be made."**

This would seem to be authority for the proposition that as long as the method of apportionment claimed by the taxpayer is **sensible and clear**, or **logical and fair**, such apportionment should be allowed by the Revenue.

In **Commissioner for Inland Revenue v Nemojim (Pty) Ltd 1983 (4) SA 935 (A) at 951D**, Corbett JA, as he then was, said the following:

> **"As pointed out in the *Rand Selections* case *supra* at 131E-G, the Income Tax Act makes no provision for apportionment. Nevertheless, apart from the *Rand Selections* case, it is a device which has previously been resorted to where expenditure in a globular sum has been incurred by a taxpayer for two purposes, one of which qualifies for deduction and one of which does not ... . It is a practical solution to what otherwise could be an intractable problem and in a situation where the only other answers, *viz* disallowance of the whole amount of expenditure or allowance of the whole thereof, would produce inequity or anomaly one way or the other. In making such an apportionment the Court considers what would be fair and reasonable in all the circumstances of the case ... ."**

After making his own apportionment on the facts of **Nemojim's case**, Corbett JA had the following to say at 958G:

> **"It has been said that "there is no equity about a tax". While this may in many instances be a relevant guiding principle in the interpretation of fiscal legislation, there is nevertheless a measure of satisfaction to be gained from a result which seems equitable, both from the point of view of the taxpayer and from the point of view of the *fiscus*. And it may be fairly inferred that such a result is in conformity with the intention of the Legislature."**

In **Tuck versus Commissioner for Inland Revenue 1988 (3) SA 819 (A)** Corbett JA said the following at 834-5:

> **"Counsel contended that there was no reason why the principle of apportionment should not be extended to the case where a receipt, having regard to its *quid pro quo*, contained both an income element and an element of a capital nature. Counsel for the respondent did not appear to dispute this as a proposition of law.**
>
> **There is, so far as I am aware, no authority for this proposition in our case law. Nevertheless, for reasons similar to those stated in the cases quoted in the previous paragraph, it seems to me that in a proper case apportionment provides a sensible and practical solution to the problem which arises when a taxpayer receives a single receipt and the *quid quo pro* contains two or more separate elements, one or more of which would characterise it as capital. It could hardly have been the intention of the Legislature that in such circumstances the receipt be regarded wholly as an income receipt, to the disadvantage of the taxpayer, or wholly as a capital receipt, to the detriment of the *fiscus*. And it is of some interest to note that the solution of apportionment in cases of this nature has been adopted in England ... .**
>
> **The problem in this case is to establish an acceptable basis of apportionment. The appellant has all along suggested apportionment on a 50/50 basis; and this was Mr Welsh's suggestion to us. Having regard to the inherent nature of the receipt and its origin in the plan, it is not possible to find an arithmetical basis for apportionment ..., but I do not think that this should constitute an insuperable obstacle ... It is not possible to infer that the one element is more important than the other and, in all the circumstances, I consider that a 50/50 apportionment would be fair and reasonable."**

In **Commissioner for Inland Revenue versus VRD Investments (Pty) Ltd 1993 (4) SA 330 (C)**, Scott J, as he then was, said the following at 342-3:

> **"It seems to me that the circumstances of the present case are such that it would be appropriate for such an apportionment to be made. ... No arithmetical basis for apportionment is possible but that does not preclude an apportionment from being made ... . In all the circumstances, it seems to me that an apportionment on the basis of twenty-five per cent**

of the expenditure being of a capital nature would be fair and reasonable to both parties."

The principle of apportionment was also applied in the case of **Van Blommestein versus Kommissaris van Binnelandse Inkomste 1997 (3) SA 908 (C) at 921 G-I** in the context of a situation where a taxpayer incurred an interest obligation in order to be able to inherit assets which were both productive and non-productive of income. He was permitted to deduct the interest in the ratio of the productive assets to the total assets inherited by him.

From all of these cases, it seems that where a Court considers it appropriate to make an apportionment, it considers what is **fair and reasonable** in all the circumstances of the case and makes an apportionment on this basis, even where no arithmetical basis for apportionment presents itself.

The question which arises in the context of motor vehicle expenses is: what is a fair and reasonable apportionment? As already stated, s 23(*g*) requires an apportionment to be made on the basis of the taxpayer's purpose, but gives no guidance as to how this should be done.

Clearly the Revenue's view is that apportionment should be made on the basis of distance travelled for the purposes of trade in relation to the total distance travelled, and, in terms of Practice Note 24, "must be based on actual figures". But is this necessarily appropriate, and what about the situation where no records of actual

distances travelled for trade and non-trade purposes are kept, as must surely be very common?

The example of an advocate because it seems fair to say that under modern conditions an advocate must have his or her car available at chambers to be used, often at short notice, to attend out-of-chambers and out-of-town consultations, inspections, court or tribunal hearings and arbitrations, and to travel to the airport to catch flights when engaged for work out of town.

It also seems fair to say that the effect of attempting to apply the provisions of paragraph 7(4) of the Seventh Schedule to the Act to a "self-employed" advocate is not only unwarranted but wholly inequitable. It completely undermines the apportionment principle, and arguably takes away the benefit of a legitimate tax deduction for expenditure incurred for the purposes of an advocate's profession.

I am aware of a case where an advocate, who shall remain nameless, objected to an assessment disallowing a claim for motor vehicle expenses on the basis that 80 per cent of the expenses, including wear and tear, were expended for trade purposes and 20 per cent for non-trade, private purposes, and instead applying the notional fringe benefit in terms of Practice Note 24. Extracts from the response to his objection received by the said advocate from the South African Revenue Service read as follows:

> **"It is readily conceded that Practice Note 24 or, for that matter, an application of paragraph 7(4) of the Seventh Schedule to the Act, is inappropriate in your particular circumstances. Moreover, I concur with your assertion that the Practice Note *per se* has no force in law.**

However, the deductibility of motor vehicle expenditure claimed by yourself is predicated on the provisions of s 11(*a*) read with s 23(*g*) of the Income Tax Act.

It is trite law that s 23(*g*) permits an apportionment, in that the critical phrase 'to the extent that' contemplates same.

Accordingly, it is respectfully submitted that *dicta* from the courts in support of apportionment are superfluous.

In the light of the above, it is submitted that you would be required, in terms of s 11(*a*), to provide me with total actual kilometres travelled, indicating kilometres travelled in respect of private on the one hand and kilometres travelled for business purposes on the other.

It is further submitted that no inference can be drawn from the fact that the Revenue have allowed you a 20 per cent add back in respect of private use of motor vehicle during your many years of practice, in that it is reasonable to submit that you could not legitimately expect or acquire a *de jure* right, based on tacit acceptance. This would imply that the Commissioner had failed to apply his mind to your particular case in the past. In this regard the annuality concept of taxation as enunciated in *Caltex Oil Ltd versus Commissioner for Inland Revenue* 1975 (1) SA 665 (A) is of relevance.

Furthermore, it is trite law that the taxpayer is required to discharge the onus as provided for in s 82 of the Act by indicating the basis on which his apportionment rests. Accordingly, you would be constrained to provide such a calculation for my consideration.

It is respectfully submitted that you have, in all likelihood, not maintained a logbook, as there is no warrant in the Act for you having to do so. However, I would readily accept your 'best estimate' of total kilometres both for private and business use based on the *dicta* in *Edgars Stores Ltd versus Commissioner for Inland Revenue* 1988 (3) SA 876 (A).

In order that this matter be expeditiously resolved, I await your apportionment based on kilometres travelled at your earliest convenience."

Although the admission regarding the inappropriateness of Practice Note 24 in this letter from the Revenue is to be welcomed, the suggestion that the *dicta* of the courts are "superfluous" cannot be accepted, for they indicate how apportionment has been

made in the past and they certainly show that apportionment is possible even where no arithmetical basis is available.

It is submitted that the appropriateness of basing an apportionment on kilometres travelled can seriously be questioned. If one accepts the assertion that it is necessary for an advocate to have a motor vehicle **available for trading purposes**, does this not amount to a trade use of the vehicle while it is parked at chambers, ready to be driven for trade purposes at any time. (For example, advocates with a criminal practice may have to attend bail hearings at a moment's notice.) Would it not be fair and reasonable, then, to base an apportionment on time rather than distance travelled. After all, finance charges and rent are, it seems, based on time. Perhaps an estimate of the time spent on private travel compared with the total time in respect of which expenses, including wear and tear or depreciation, are incurred would provide a more appropriate basis for apportionment.

What can be said, in conclusion, is that to base the extent of private travel, and thus apportionment, on a notional fringe benefit is entirely lacking in logic, bereft of statutory authorisation, and arbitrary.

The arbitrariness of using the concept of a notional fringe benefit can be seen from the fact that value of the fringe benefit was recently increased from 1,2 per cent of the "determined value" of a motor vehicle to 1,8 per cent per month. Overnight the value of the taxpayer's private use of his or her motor vehicle was increased by 50 per cent.

The arbitrariness is also evident from a consideration of the position once the motor vehicle has been fully depreciated, after say five years. Is the notional fringe benefit to continue? Surely not, but what would be the position as regards apportionment then? The Practice Note contains no answer to these questions.

And what about recoupments when the vehicle is sold? Is the full amount of wear and tear or depreciation claimed to be taken into account in determining its tax value, or only the wear and tear or depreciation less the cumulative amount of the notional fringe benefit on which the taxpayer has been taxed?

The uncertainty as to the answers to these questions demonstrates the manifest shortcomings of the use of a notional fringe benefit as suggested in Practice Note 24.

What can safely be said, however, is that, in terms of the law, as distinct from any practice of the Revenue, no convenient rule of thumb will be acceptable in all circumstances, and that a *bona fide* apportionment can only be arrived at by taking into account all the particular circumstances of individual taxpayers' situations, however inconvenient this might be to the South African Revenue Service.

Let us not to the separation of joint estates admit (fiscal) impediment:

An examination of the income tax consequences of an order in terms of s 7 (8) of the divorce act.

BY NATHIERA ABDULLAH

UNIVERSITY OF CAPE TOWN

LET US NOT TO THE SEPARATION OF JOINT ESTATES ADMIT (FISCAL) IMPEDIMENT:

AN EXAMINATION OF THE INCOME TAX CONSEQUENCES OF AN ORDER IN TERMS OF S 7 (8) OF THE DIVORCE ACT.

The dissolution of a marriage is doubtless in many, if not most, cases a disagreeable terrain to traverse when it comes to division of the parties; on divorce. It is moreover not uncommon for difficulties of a proprietary nature to persist well after the bonds of matrimony have been severed. Yet it nevertheless seems somewhat strange for a dispute concerning the proprietary consequences of divorce to find its way into the income tax court.

The Commissioner for Inland Revenue has not been known to have qualms about seeking to tax someone other than the ultimate recipient of income where he considers that a prior accrual has taken place in such other person's hands (cf *Commissioner for Inland Revenue v Witwatersrand Association of Racing Clubs* 1960 (3) SA 291 (A)). But while it has been said that 'there is no equity about a tax' (see the *dictum* of Rowlatt J in *Cape Brandy syndicate v IRC* (1932) 1 KB 64 at 71), taxpayers tend to feel understandably aggrieved when they are subjected to tax on income which is

in truth not theirs but the income of another (cf *Geldenhuys v Commissioner for Inland Revenue* 1947 (3) SA 256 (C); *Secretary for Inland Revenue v Smant* 1973 (1) SA 754 (A); *Van Blommestein v Kommissaris van Binnelandse Inkomste* 1997 (3) SA 908 (C)).

It is not altogether surprising, then, that the Cape Income Tax Special Court was recently faced with a taxpayer resisting an attempt by the Revenue to tax in his hands a lump sum paid by a pension fund to his ex-wife.

The facts of *Case No 10404* (unreported at the time of writing) were that Mr X had been married in community of property to Mrs X prior to the dissolution of their marriage on 27 April 1990. In terms of a consent paper incorporated in the order of divorce, Mrs X's 50 per cent interest in the pension fund of which Mr X was a contributing member was recognised as at the date of divorce, and was to be noted in the records of the fund. This was done in terms of s 7(8) of the Divorce Act, 70 of 1979, which provides *inter alia* as follows:

> '7(1) A court granting a decree of divorce may in accordance with a written agreement between the parties make an order with regard to the division of the assets of the parties or the payment of maintenance by one party to the other.
>
> (7)(*a*) In the determination of the patrimonial benefits to which the parties to any divorce action may be entitled, the pension interest of a party shall, subject to paragraphs (*b*) and (*c*), be deemed to be part of his assets.

(*b*) The amount so deemed to be part of a party's assets, shall be reduced by any amount of his pension interest which, by virtue of paragraph (*a*), in a previous divorce -

(i) was paid over or awarded to another party; or

(ii) for the purposes of an agreement contemplated in subsection (1), was accounted in favour of another party.

(8) Notwithstanding the provisions of any other law or of the rules of any pension fund -

(*a*) the court granting a decree of divorce in respect of a member of such a fund, may make an order that -

(i) any part of the pension interest of that member which, by virtue of subsection (7), is due or assigned to the other party to the divorce action concerned, shall be paid by that fund to that other party when any pension benefits accrue **in respect of** that member;

(ii) an endorsement be made in the records of that fund that that part of the pension interest concerned is so payable to that other party;

(*b*) any law which applies in relation to the reduction, assignment, transfer, cession, pledge, hypothecation or attachment of the pension benefits, or any right in respect thereof, in that fund, shall apply *mutatis mutandis* with regard to the right of that other party in respect of that part of the pension interest concerned.'

(Emphasis supplied)

'Pension interest' is defined in the Act as follows:

'"Pension interest", in relation to a party to a divorce action who -

(*a*) is a member of a pension fund (excluding a retirement annuity fund), means the benefits to which that party as such a member would have been entitled in terms of the rules of that fund if his

> membership of the fund would have been terminated on the date of the divorce on account of his resignation from his office'.

In due course Mr X left the services of his employer, and this resulted in his withdrawal from the employer's pension fund on 31 July 1991, which triggered the payment of lump-sum benefits by the fund.

An amount of R7 151 was paid by the fund to Mrs X in respect of her 50 per cent interest in the fund as at the date of divorce, but this amount was taxed in the hands of Mr X, on the basis that it first accrued to him and therefore constituted gross income in his hands.

Mr X objected to his 1992 assessment on the ground that the amount of R7 151 was not gross income in his hands. His objection was disallowed and the matter proceeded to the Special Board constituted in terms of s 83A of the Income Tax Act, 58 of 1962, as amended, ('the Act'). The Special Board found in his favour and the Commissioner for Inland Revenue, who was dissatisfied with the outcome, referred the matter to the Special Court for a hearing *de novo*.

The relevant provisions of the Act were as follows.

Paragraph (*e*) of the definition of 'gross income' in s 1 of the Act included in gross income:

> 'any amount determined in accordance with the provisions of the Second Schedule in respect of lump

sum benefits **received by or accrued to** such person from -

(i) any fund which has in respect of the current or any previous year of assessment been approved by the Commissioner ... as a pension fund ...;

... if such person was a member of such fund during any such year ...'.

(Emphasis supplied)

Paragraph 2 of the Second Schedule to the Act provided that:

'The amount to be included in the gross income of any person in terms of paragraph (*e*) of the definition of "gross income" in section *one* of this Act shall be the aggregate of the amounts **received by or accrued to** such person by way of lump sum benefits during any year of assessment from any pension funds, provident funds or retirement annuity funds, less the deductions permitted under the provisions of this Schedule.'

(Emphasis supplied)

Section 7(2A) of the Act provided that:

'In the case of spouses who are married in community of property -

(*a*) any income (other than income derived from the letting of fixed property) which has been derived from the carrying on of any trade shall, if such trade is carried on -

(i) by only one of the spouses, be deemed to have accrued to that spouse; ..."

and s 7(2C) provided that:

'For the purposes of subsection (2A) -

(*a*) any benefit paid or payable to a spouse in his capacity as a member or past member of a pension fund, provident fund, benefit fund or retirement annuity fund shall be deemed to be income derived by such spouse from a trade carried on by him. ...'

Subsections 7(2A) and (2C) were not directly relevant to the issue in *Case No 10404* because Mr and Mrs X, being divorced, were no longer married in community of property; but they show how the lump sum would have been taxed if the marriage in community of property had not been ended.

The issue to be decided by the Court was whether the amount paid to Mrs X by the pension fund was 'received by' or had 'accrued to' Mr X during the 1992 year of assessment.

Traverso J, giving judgment on 26 March 1997, made the following findings:

1. It was clear on the facts that the amount in question had never been received by Mr X. The question to be decided was therefore whether it could be said to have 'accrued' to him.

2. What the Legislature contemplated in enacting s 7(8) of the Divorce Act was that when the member became entitled to his pension benefit, the fund had to pay the amount due to the non-member who had acquired an interest therein on divorce. The wording of s 7(8) was significant in that it provided that the time when the non-member had to be paid was the time when the pension benefits 'accrued in respect of' (as opposed to 'accrued to') the member.

3. On the authority of *Commissioner for Inland Revenue v People's Stores (Pty) Ltd* 1990 (2) SA 353 (A), the question was who had become 'entitled to' the amount of R7 151.

4. As from the date of divorce, Mrs X's estate became the owner of a 50 per cent share of the pension interest as at the date of divorce. Mr X's entitlement to benefits under the pension scheme came into existence when his membership of the fund was terminated, and it was only then that a 'money value' could be attached to his rights. At this time, however, he no longer had any entitlement whatsoever to the 50 per cent interest owned by Mrs X.

5. Because Mrs X had become the owner of a 50 per cent interest in the fund, it was untenable to argue that the benefit of R7 151 first accrued to Mr X and was then paid to Mrs X. The benefit accrued solely to Mrs X.

The appeal was accordingly allowed and the Commissioner was directed to reduce the taxpayer's gross income for the 1992 year of assessment by the amount of R7 151.

It is considered that the findings of Traverso J are, with respect, correct. The appellant's wife acquired her entitlement to a 50 per cent share of the pension interest of the joint estate on the date of divorce, but there was at

that time no 'amount' to which she was entitled. She only became entitled to an amount when the event which prompted payment of the lump sum by the fund, namely the withdrawal of the appellant, occurred. (Prior to the appellant's withdrawal from the fund the pension interest was notional, and presumably the appellant's wife was entitled to investment growth on her share thereof between the date of divorce and the date of accrual of the lump sum, the appellant as member being entitled to growth on his 50 per cent share of the pension interest as at the date of divorce and all subsequent contributions made by him.)

One imagines that there are two reasons why the Revenue was anxious to tax the amount in question in the hands of the appellant. Firstly, if it could not be taxed in his hands it was not taxable at all. A lump sum paid by a pension fund is of a capital nature (see *Meyerowitz on Income Tax* para 23.32) and therefore not taxable in terms of the general definition of 'gross income'; and it is only in terms of para (*e*) of that definition that it is taxable. But para (*e*) expressly states that a lump sum received or accrued is taxable only if such person is or was a member of the fund. Thus, a lump sum accruing to a non-member such as the appellant's wife, if it is not taxable in the hands of the member, is not taxable at all.

The second reason why the Revenue may have felt entitled to levy tax in the hands of the appellant is, one surmises, to be found in s 7(8) of the Divorce Act *supra*, which provides

that 'any part of the pension interest ... which ... is due or assigned to the other party ... shall be paid by that fund to that other party when any pension benefits **accrue in respect of** that member'. But as the Court pointed out, with respect correctly, an accrual **in respect of** the member does not mean an accrual **to** that member. The whole point of an order in terms of s 7(8) of the Divorce Act is to establish the non-member spouse's entitlement to his or her pension benefit prior to the time when it is quantified as an amount and such amount accrues by virtue of the member's withdrawal from the fund. As Melunsky J said in **Schenk v Schenk** 1993 (2) SA 346 at 350F:

> "The provisions of section 7(8) of the Divorce Act clearly envisage that payment of the pension interest will be effected at some future time: hence the need to protect the non-member's rights by providing for an appropriate endorsement to be made in the records of the fund."

Although Traverso J did not deal with this point, there is another basis on which the amount of R7 151 could have been excluded from the appellant's gross income. As Goldstone JA said in *Minister of Finance v Law Society of Transvaal* 1991 (4) SA 544 (A) at 557C, the words 'received by or accrued to' in a revenue statute:

> 'over many years, have been judicially interpreted to describe a receipt by, or an accrual to, the taxpayer on his own behalf or for his benefit'.

Thus even if the appellant could have been said to have suffered an accrual, it would not have been on his own behalf or for his own benefit: it would have accrued to him on behalf of and for the benefit of his ex-wife. It is considered that on general principles of tax law this would have been enough to exclude the amount of R7 151 from his gross income.

The effect of the decision in *Case No 10404* is that a lump sum paid to a non-member as a result of an order in terms of s 7(8) of the Divorce Act escapes liability for income tax altogether. This may be an untenable position from the Revenue's point of view, but the obvious solution is to place an amendment to the Act before Parliament, not to seek to tax an amount that accrues to and is received by a non-member in the hands of the member whose income it never will be.

A curious aspect of *Case No 10404* is that the Court maintained silence on the question of costs. It is understood that the appellant's counsel asked that the appeal be allowed with costs in terms of s 83(17) of the Act, which provides that:

> 'The court shall not make any order as to costs save when the claim of the Commissioner is held to be unreasonable or the grounds of appeal therefrom to be frivolous **or where the decision of the Board referred to in section 83A is substantially confirmed.**'

The decision of the Special Board was indeed substantially confirmed by the Special Court, so *prima facie* this was a matter where costs could have been awarded against the Revenue.

Van Reenen J, sitting as President of the Cape Income Tax Special Court and confirming the decision arrived at by the Special Board, said the following in ITC xxxx xx SATC xxx:

> 'The conclusion arrived at herein is the same as that arrived at by the Special Board.
>
> Accordingly this court is statutorily empowered to make an award of costs. This Court is a creature of statute (see *Commissioner for Inland Revenue v Taylor* 1934 AD 387 at 390) and accordingly, unlike the Supreme Court, does not possess any inherent discretionary powers as regards costs.
>
> As the jurisdictional facts alluded to in section 83(17) of the Act are present there is no basis upon which the taxpayer's request that he should be awarded costs can be refused.'

In *ITC 1602* 58 SATC 205 Galgut J expressed himself differently on the question of costs where the Commissioner had been successful in the Board and succeeded again in the Special Court. Declining to make an award of costs, he said the following at 211-2:

'The conclusion we have reached is in the circumstances the same as that reached by the Special Board. The Commissioner's representative therefore asks that the taxpayer be ordered to pay the Commissioner's costs. ...

It is not suggested that the taxpayer's appeal has been frivolous. The costs are sought solely on the ground that our decision substantially confirms that of the Special Board. The Commissioner's representative submits that the Special Court has no discretion in this regard and that I am therefore compelled to make the costs award. That is not however what s 83(17) says. It merely precludes costs from being awarded, save in the named circumstances. It does not lay down the converse, that is to say that in the event of the named circumstances being present the Special Court is obliged to make a costs award. As far as I am aware both the Supreme Court and all other specially constituted courts retain a discretion. Equity and justice dictate that this should as far as possible always be so, and there is no reason to hold otherwise. I conclude therefore that I have a discretion.

On the facts of this case there is no reason to order the taxpayer to pay the costs. Apart from the fact that there is nothing in the taxpayer's case which warrants it, I would in any event hesitate to make any order which might unnecessarily discourage other taxpayers from appealing. The principle that a taxpayer should not be discouraged from appealing is in my view not altered by the fact that section 83A has interposed the Special Board as a tribunal for appeals. The wording of s 83A(14) shows that the appeal before the Special Court is as such not an appeal from the decision of the Special Board. On the contrary, it is a hearing *de novo* of the same appeal that served before the Board. The appeal *de novo* is furthermore an appeal as of right, and in the absence of something more there is no reason to order a taxpayer to pay costs simply because the decision reached is substantially the same as that reached by the Special Board.'

Whatever the correct position, it is somewhat surprising that in *Case No 10404* Traverso J did not deal with the request for costs at all.

A final point to be made concerning the income tax implications of orders in terms of s 7(8) of the Divorce Act is that they are not limited to marriages in community of

property. There is nothing to prevent spouses married out of community of property from assigning a portion of their pension interest to the non-member spouse in a consent paper incorporated in the order of divorce. Where this is done the effect of the decision in *Case No 10404* is that a lump sum paid to the former spouse who is not a member of the fund will escape tax altogether.

This may seem a wonderful retirement planning device from the taxpayer's point of view, but the hazards of using divorce as a retirement planning strategy are obvious. The member former spouse might succeed in keeping a substantial amount of tax out of the clutches of the Revenue, but he or she might also unwittingly succeed in keeping the entire lump sum paid to the non-member former spouse out of his or her own clutches.

Doubtless, however, the Revenue will act to remove any such temptation from taxpayers planning a retirement free of both tax and matrimony - by placing a suitable amendment before the Legislature.

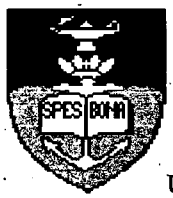
A PAPER PRESENTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS OF THE MASTER OF LAWS (TAXATION) DEGREE

CASUAL SERVICES RENDERED

VERSUS

CAUSAL SERVICES RENDERED

BY NATHIERA ABDULLAH

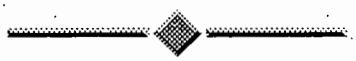


UNIVERSITY OF CAPE TOWN

CASUAL SERVICES RENDERED

VERSUS

CAUSAL SERVICES RENDERED



To determine whether a particular receipt is to be included in a taxpayer's 'gross income', one should first consider whether it falls within the general concept of 'income'. A further inquiry should then be made in terms of paragraphs (a) – (n) of the statutory definition of gross income.

At common law, an amount received for services rendered or to be rendered has the quality of 'income' (as opposed to capital), while a voluntary award or a gratuitous receipt will generally be of a capital nature. Thus whether an amount was received voluntarily or gratuitously for services rendered (or holding an office or employment) para (c) will find application, provided there is a causal link between the services rendered (or holding an office or employment) and the amount received.

The aim of this paper is to discuss the issue of whether 'casual services rendered', as opposed to 'causal services rendered', is

subject to tax in terms of section 1 paragraph (c) of the Income Tax Act No 58 of 1962, as amended ("the Act"). I refer to the following case scenario:

The taxpayer runs a very successful business in A, catering for the tourist industry. He is well known as "the public relations and publicity man" in B, and generally in C. Besides his restaurant known as D Café, he also provides accommodation for overnight travellers as well as tourists. He is well known in the area, and internationally, for the services he renders to the local population, as well as to visitors and tourists.

The taxpayer was approached by certain foreigners who said that they wanted to acquire concessions for the mining and obtaining of diamonds.

After he had shown them around and discussed matters with them, it appeared that they were not interested in diamond mining concessions but in illegally obtaining uncut diamonds.

Realising he could become implicated in potentially criminal activity, the taxpayer approached the diamond branch of the South African Police, disclosed information to them and inquired what he should do, as he did not wish to be implicated in anything which could be detrimental to his standing as a prominent resident and

leader of the local community, or damage his business and other interests.

The information disclosed by the taxpayer to the police resulted in the conviction of the persons in question, and in due course the taxpayer was paid R200 000 by the police as a reward for the information leading to their arrest, prosecution and conviction.

In making the aforesaid disclosure to the police, the taxpayer – mindful of the fact that he might otherwise have become implicated was motivated by the desire to safeguard his name, his business and his standing in the community.

The Commissioner for Inland Revenue levied income tax on the amount of R200 000 received by the taxpayer, and the taxpayer objected to the assessment in question and appealed to the special court for hearing income tax appeals, on the grounds that:

1. the reward is a receipt of a capital nature and therefore does not fall within the general definition of 'gross income' in section 1 of the Act, as amended; and

2. it is not an amount received "in respect of services rendered" as contemplated in paragraph (c) of the definition of gross income.

In the above scenario there is no question of employment or the holding of any office. The question to be decided is whether the amount received was received "in respect of services rendered".

PURPOSE OF PARAGRAPH (C)

In paragraph (c) it is necessary to establish that the amount received was "in respect of" services rendered or to be rendered, as specified in the Act.[1]

Prior to the amendment of para. (c), an obligation to pay had to be established, if there was no obligation, there could be no payment.[2] If payment was in the nature of a donation or a reward, the amount was always "in respect of" a transaction of a capital nature.

"7. (1) For the purposes of this Chapter-

[1] Section 1. 'gross income' para. (c).

[2] CIR v Lunnon 1924 AD 94, 1 SATC 7

"gross income" means the total amount whether in cash or otherwise received by or accrued to or in favour of any person, other than receipts or accruals of a capital nature, in any year or period assessable under this Chapter from any source within the Union or deemed to be within the Union, and includes the following-

(a) .....

(b) any amount so received or accrued in respect of services rendered, whether due and payable under a contract of service or not;"[3]

In the case of CIR v **Lunnon 1924 AD 94, 1 SATC 7**, the legal question before the court was whether the gratuity paid to the taxpayer, after the termination of his services as a director, formed part of his gross income or not. The facts of this case were briefly as follows:

The taxpayer, a company director, resigned from the board of directors, in December 1920. In June 1921, the directors agreed to request the shareholders to grant the taxpayer and another retired

[3] Income Tax Act No 40 of 1925.

director gratuities of 1 000 and 500 pounds, respectively, in recognition of their valuable services on the board in previous years when director's fees were not commensurate with the work involved, and a *solatium* for the loss of their seats when the head office was transferred to Johannesburg.

The court sought to determine the legal nature of the payment, more particularly the legal relationship of the parties in question.

> **"Payment is in law the extinction of an obligation. Here there was no *obligatio*, and therefore there could be no solutio. Lunnon had no claim against the company, and it was under no indebtedness to him. He had been paid in full for his services which had terminated, and could claim no more. So that all the essentials of a donation were present. And the fact that the motive which actuated the donor was gratitude for past services in no way altered the legal nature of the transaction. In law, therefore, the grant of L1000 voted to Lunnon was a gift pure and simple...."**
>
> **"I should like to refer to what was said in Booysens case; where it was pointed out that income was sometimes the product of capital invested, and sometimes was earned by**

the labour or the wits of the recipient. Now this gift has none of the attributes of income; it was not produced by the respondent's capital, nor was it earned by his labour or his wits or in any other way. There is no recurrence about it. What is sometimes called an annuality is not necessarily a decisive test as to whether a receipt or accrual is capital or income; but it is an important element to be taken into consideration. And in the present instance it is wholly absent."

Innes CJ further stated:

"[W]hat is the meaning of 'any other benefit or advantage of any kind granted in respect of employment' which are the words relied upon?

"Clearly the employment to which they relate, and in respect of which the benefit is given must be employment the obligation for which was undischarged at the date of the grant. They cannot refer to employment which had already terminated, and all obligations arising from which had been wiped out..... Looking therefore at the provision of our Act, I am of the opinion that the grant voted to respondent by the shareholders constituted a receipt by

him of a capital nature and does not fall within the definition of gross income in s6..."

The reasoning expounded by Innes CJ was that unless the payment was given in lieu of an obligation, there could be no solutio and hence outside the scope of income tax

In response to the judgment in the above case, the legislature amended the definition of 'gross income' to include **'any voluntary award, received or accrued in respect of services rendered or to be rendered'.**

By virtue of the provisions of paragragh (c), "gross income" includes:

> "(c) any amount, including **any voluntary award, received or accrued in respect of services rendered** or to be rendered or any amount (other than an amount referred to in section 8 (1)) received or accrued in respect of or by virtue of any employment or the holding of any office..." **(my emphasis)**

If a reward is closely identified with and finds its origin in the fact of employment, the amount is taxable whether it is made in lieu of an obligation or not and it makes no difference whether such award is paid by way of a donation, moral obligation or of a contractual right. If its origin is that of services rendered, from which the gratuity flows, then the amount is taxable.

> **"So that the question whether there is any contractual obligation has become irrelevant. The only question for the Court to decide is why the payment was made."[4]**

Wessels JA in **De Villiers v CIR**[5] stated:

"It makes no difference whether we consider the money paid to him as a gratuity or as a moral obligation or as a contractual right; its origin must be sought for in the fact that he served the State as Attorney-General; that fact is the fountain from which the gratuity flows."

WHAT ARE SERVICES RENDERED?

For the taxpayer to be subjected to the provisions of para. (c), the true nature of the quid pro quo given by the taxpayer must be

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[4] ITC 599. 14 SATC 272. at p273; see also ITC 799, 19 SATC at 326.

[5] 1929 ad 227, 4 SATC 86, at 232

regarded as services rendered. There must be a nexus between the payment received and the act performed by the taxpayer. One also has to establish the legal relationship between the taxpayer and the party who pays for the services provided by the taxpayer. Generally, the types of contracts of service are classified as *locatio conductio operis* (the letting and hiring of work) or location *conductio operarum* (the letting and hiring of services).[6]

Locatio conductio operarum, or huur van diensten, is a contract whereby one person lets out his services to another person who hires them in return for renumeration. Reciprocal obligations exist and where one party can unilaterally terminate the contact, then no contract of service is constituted.

Locatio conductio operis is a contract where the person who does the work is the locator, while the conductor is the person for whose benefit the work is performed and who pays the remuneration.

DOES THE PASSING ON OF INFORMATION AMOUNT TO A SERVICE RENDERED?

Generally and in terms of common law, failure to inform the police of the commission of a crime, does not amount to a crime, unless the person concerned is under a legal duty to act.[7]

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[6] Wille's Principles on South African Law, eigth edition, 1991, p560, 571

> **"A person who, knowing of the intended commission of a crime, gives no warning to the authorities or to the intended victim , or a person who, being present at the commission of a crime, takes no steps, even though it be within morally deserving of severe opprobrium, is not criminally punishable unless his omission can be proved to have been designed with the object of assisting the perpetrator of the crime...".**[8]

Notwithstanding the absence of a contractual obligation or the existence of a legal duty, the passing of the information by the taxpayer may still fall within the ambit of para. (c):

> **"The services referred to are not confined to employment as such, but include any form of service, eg professional services, such as medical, legal, architectural, or as a director, and so on, and casual services, eg passing on some information. The services need not be rendered by virtue of any contract nor need the amount received or accrued be**

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[7] Principles of Criminal Law: Jonathan Burchell, John Milton, first edition, 1991.
[8] Gardiner and Landsdowne, sixth edition, p148

by reason of any contract or obligation: it can be a purely voluntary payment."[9]

In ITC 701,[10] the taxpayer, a racehorse trainer, received a gift from a racehorse owner (other than the owner on whose behalf he trained the winner of an important race) following his winning a considerable sum as a result of betting on the horse in question. The court held that since the payment was not made in pursuance of any antecedent arrangement or in consideration of any information given or of any services rendered by the taxpayer to the donor but was merely as a result of a generous act by a successful punter, the amount was a receipt of a capital nature.

Taking cognisance of the purpose of the provisions of para. (c) and the authorities cited above, the question still remains whether a unilateral act performed by one party could validly give rise to a "service rendered", within the context of para.(c), in the absence of contractual obligations (whether by conduct or tacitly) or the existence of a legal duty.

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[9] Meyerowitz on Income Tax 1997-1998 edition, para 9.12, 9.13.

[10] 17 SATC 108. Cf. it was also held in this case that a further amount which was paid by the owner of the racehorse, as a consequence of its wining, was part of the income of the taxpayer, in question.

In ITC 779, 19 SATC 326, the court had to determine, (in terms of s7 (b), Act 31 of 1941) an amount received by the taxpayer in recognition of information which led to the conclusion of a successful financial deal, was capital or revenue in nature. The court came to the conclusion that on the facts, the amount in question was received in respect of services rendered.

De Wet J stated that:

> **"In my view the section, which states "any amount, including any voluntary award, so received or accrued in respect of services rendered or to be rendered", includes any services rendered whether they arise out of a contractual relationship or not.....What did concern me was whether the services here rendered were such services as one could call "services rendered" within the meaning of the section. But the difficulty that I had in that regard is really answered by the appellant himself, because when he was asked why he thought he received the money he in a genuine and honest way told the Court that it was because of the information he had passed on. That is how the people who paid him the money regarded the matter – they said that this was commission earned by him and they actually included it in the price they paid for the shares they eventually bought. So it is not casual information which he passed on. It is a little more than that because the appellant saw certain persons with their heads together and went out of his way to send a telegram to the managing director of the company which subsequently acquired the shares, suggesting that it was likely that the proprietary company would be selling out and**

asking whether he was interested. That amount to rendering of services, and the remuneration he received was in regard to such services."[11]

This case clearly recognises that a unilateral act cannot in itself constitute "services rendered". Some contract of service must exist, whether tacitly, by conduct, before it can be said that a taxpayer had rendered a service.

The taxpayer in the case scenario had no legal duty (one may argue that a moral obligation existed), nor any contractual obligation to inform the police of a crime which may or may not be committed. The taxpayer's reasons for departing with the said information would be to ensure that he would not be at risk of being criminally implicated, as an accomplice, etc. However, the taxpayer did not anticipate a reward for the disclosure of such information. Had he been aware of a reward, then he may have fallen within the ambit of para (c).[12]

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[11] at p327

[12] ITC 779, 19 SATC 326 at 327

CAUSATION

Words acquire meaning in the context in which they are used, the same applies to the phrase 'in respect of', which according to Solomon JA in **Commissioner for Inland Revenue v Crown Mines,Ltd 1923 AD 227 at 228,** may be used in various senses and in each it is essential to examine the context in order to ascertain the sense in which it is used.

In **De Villiers v CIR (supra)** the context within which this phrase appeared in s 7 (1) (b) of Act No 40 of 1925 led Stratford JA to follow the interpretation of Innes CJ in **CIR v Crown Mines Ltd (supra)** of the same phrase where he held that:

> **"tax could not be said to be imposed "in respect of a particular subject-matter, unless it had direct relationship to that matter, by which is meant, I think, 'casual relationship'..."**[13]

In **CIR v Butcher Bros (PTY) Limited 1945 AD 301 at 320; SATC 13 21** it was stated that although the words may infer a causal relation, it may not always be the case. In this case the meaning of the words

"in respect of" as used in s7 (1)(d) of the Act 40 of 1925 was stated to mean "in relation to" or "in reference to".

In **SIR v Raubenheimer 1969 (4) SA 314 (A) at 320; SATC 31 209** it was stated that subject to the context in which they appear, the words are capable of a wider interpretation than that of a direct relationship and stated further that he could find nothing in the case of **De Villiers v CIR 1929 AD 227, 4 SATC 86**, which indicates that the words "in respect of" always point to a direct relationship.

The words in para (c), "in respect of" means that there is a direct relationship, not a casual relationship and thus in every case it is a question of drawing the correct inference from all the circumstances of the payment received.[14]

In the case of **Stander v Commissioner for Inland Revenue 1997: 1 JTLR 5**, one of the issues, inter alia, was whether the award received by the taxpayer was received "in respect of" services rendered'. The facts are briefly as follows:

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[13] The word 'casual' in this dictum has been read in subsequent judgments and by authors as being a spelling mistake. It should apparently have been 'causal relationship'.

[14] De Villiers v CIR, 1929 AD. per Stratford JA at 227,quoting with approval the remarksof Innes CJ in CIR v Crown Mines Ltd., 1923 AD 121, at p 125-130.

The Delta Motor Corporation (Pty) Ltd, a manufacturer and distributor of motor vehicles, marketed its products through franchise dealers. One such dealer was Frank Vos Motors (Pty) Ltd, which held a franchise in the Worcester district. From about 1980 the taxpayer, Stander, was employed by Frank Vos Motors as secretary/bookkeeper. In terms of the franchise agreement, Frank Vos Motors was required to furnish monthly financial reports to Delta. These reports were drawn up by the taxpayer and forwarded by Frank Vos Motors to Delta. Towards the end of 1988 the taxpayer received an invitation from Delta to attend a convention in Johannesburg. There it was announced that he had been adjudged one of the top five bookkeeper/accountants of the franchise dealers in South Africa. In recognition of achieving excellent standards of performance in financial management, the taxpayer was awarded a prize consisting of a seven-day overseas holiday for himself and his wife. The cost to Delta of the airfares and accommodation for the taxpayer and his wife on the trip to England, France and Switzerland amounted to R14 000.

The taxpayer did not include any amount in respect of the prize he had received in his tax return for the 1990 year of assessment, but in due course the Commissioner for Inland Revenue issued a revised assessment including an amount of R14 000 in his taxable income in

respect of the value of the prize. The taxpayer's objection to this assessment was disallowed and he appealed unsuccessfully to the Special Court.

On appeal to a Full Bench, Friedman JP stated that:

> **The only provision under which the taxpayer could be taxed was para. (c) of the definition of 'gross income' --- The question as to whether the prize of an overseas trip constituted "property" , one had to ask whether the taxpayer, by being given this trip, had acquired a right which had monetary value in his hands. At no stage had the taxpayer received any "property" on which a monetary value could be placed in his hands, and he was unable to turn the prize into money or money's worth neither after accepting the award, nor earlier at the time when the donation was still an executory donation.**
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> **As to the causal requirement of para. (c) , namely that an amount had to be received or accrued "in respect of services rendered", the fact that the taxpayer's employment with Frank Vos Motors was a sine qua non of the receipt by him of the reward was insufficient. The services rendered by him to Frank Vos Motors were not the causa causans of the award. The taxpayer had not sought the**

prize by entering a competition, nor had he expected to receive anything from Delta for the work performed for Frank Vos Motors. He merely performed his duties for which he was remunerated by his employer. What qualified him to receive the prize was the fact that these duties were performed in a manner which delta considered to be excellent. The prize had the quality of testimonial or accolade rather than a reward for services rendered. The taxpayer rendered no services to Delta.

Having regard to the conditions applicable to the enjoyment of the award, the overseas trip had no "value" in the taxpayer's hands which brought it within the terms of para. (c). Unless the award consisted of "money's worth", it did not qualify for inclusion in terms of para. (c). Nor was there any basis on which "money's worth" could be attributed to the taxpayer's prize by seeking to place an 'objective' or 'market value' on it. Whatever it cost Delta, or whatever a person who wished to go on such a trip would have had to pay for it, did not constitute an amount which could be said to have had money's worth in Stander's hands.

The appeal was allowed with costs.

The taxpayer, in the case scenario, received a reward to which he had no legal entitlement and it was thus purely of a fortuitous nature. The disclosure of the information to the police was the *sine qua non* for the receipt of the reward. However, the *sine quo non* test is insufficient to establish the requisite degree of causation, as was held in Stander's case supra. The correct test is to determine whether the services rendered were the *causa causans* of the amount received.

From the given facts, the taxpayer was not aware of any reward for disclosing information to the police, which **may** lead to the arrest and conviction of criminals in certain circumstances. As stated earlier, the reason for the taxpayer's act may have been to prevent himself from being implicated in any criminal activity.

In **Commissioner for Inland Revenue v Shell Southern Africa Pension Fund 1984 (1) SA 672 (A)** the court had to determine whether a lump-sum payment from a pension fund to the widow of a deceased member was a lump-sum benefit which became recoverable "in consequence of or following upon' the death of the member within the terms of para (e) of the definition of "gross income'. The payment was in the discretion of the committee administering the fund. Nicholas JA held that the problem was one

of causation, i.e. whether, in a case where a lump sum becomes recoverable as a result of the exercise by the committee of its discretion, there is the required causal connection between the recoverability and the death of the member.

Nicholas JA stated at 679B-F:

> **"It is clear that the death of the member is a *conditio sine qua non* to the recoverability of the lump sum: but for the death, there can be no pension granted to an eligible widow or eligible dependant, and hence nothing which is commutable under rule 37(3). A conditio sine qua non is not, however, necessarily a causally relevant factor. (See Hart and Honore Causation in the Law at 107, 121-2). As Denning J pointed out in Minister of Pensions v Chennell (1947) 1 KB 250 at 255 in fin, the latest event in a train of physical events is not necessarily 'caused by' the first event. The learned Judge said at 254 that:**
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> **'the test of causation is to be found by recognising that causes are different from the circumstances in or on which they operate. The line between the two depends on the facts of each case'**

and observed at 256 that an intervening cause or extraneous event may be so powerful a cause as to reduce what has gone before to part of the circumstances in which the cause operates.

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

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

The court held that the decision of the committee did constitute the intervention of "an independent, unconnected and extraneous causative factor or event" which isolated the death of the member from the final result. Thus the lump sum did not become recoverable in consequence of or following upon the death of the member.

The difficulty in ascertaining the necessary causal relationship between the receipt and the activities of the taxpayer is also well illustrated in the case of **Stander v Commissioner for Inland Revenue 1997 (3) SA 617.**

In **Tuck v Commissioner for Inland Revenue 1988 (3) SA 819 (A), 49 SATC 28,** the facts were briefly as follows:

In 1979, the taxpayer, a recognised pharmacist, retired after 30 years in the employ of Wyeth Laboratories (Pty) Ltd ('Wyeth'). In 1957 he became its managing director and general manager. The company was a subsidiary of an American company, American Home Products Corporation ('American Home'). In 1967 the latter established a management incentive plan, the purpose being to provide awards to selected employees who had contributed substantially to the success of the company, to allow them to participate in that success and provide an incentive to contribute further. The awards took the form of cash, contingent cash or contingent stock. A contingent stock award operates as follows. The amount of the award was converted into shares in American Home. After the employee retired, the shares were delivered to him in ten annual instalments. The terms of the plan provided that the shares would not be delivered to an employee after his

retirement unless he had, inter alia, refrained from entering into competition with the company, (the 'restraint provision').

It was common cause that the taxpayer had made a major contribution to Wyeth's prosperity. He had served on a number of pharmaceutical commissions and committees, and was described in evidence as an 'outstanding personality' in the industry. His particular strengths were his knowledge and experience in marketing and the good relationships he had built up with various public authorities concerned with the pharmaceutical industry. During the 1981 tax year, the taxpayer received an initial instalment of shares worth R14 251. During the 1982 tax year he received a further instalment of shares worth R20 997.

The question before the court was whether the consideration paid to the taxpayer in terms of the management incentive plan income, or was it capital in nature?

"....it is generally recognised that causation in the law of delict gives rise to two distinct enquiries. The first, often termed 'causation in fact' or factual causation'; is whether there is a factual link of cause and effect between the act or omission of the

party concerned and the harm for which he is sought to be held liable; and in this sphere the generally recognised test is that of the *conditio sine qua non* or the 'but for' test. This is essentially a factual enquiry. Generally speaking no act or omission can be regarded as a cause in fact unless it passes this test. The second enquiry postulates that the act or omission is a *conditio sine qua non* and raises the question as to whether the link between the act or omission and the harm is sufficiently close or direct for legal liability to ensue; or whether the harm is, as it is said, 'too remote'. This enquiry (sometimes called 'causation in law' or 'legal causation') is concerned basically with a juridical problem in which considerations of legal policy may play a part. One of the factors which may cause the link between the act or omission and the harm to become too tenuous (resulting in the harm being too remote) is the intervention of some independent, unconnected and extraneous causative factor or event, generally termed *a novus actus interveniens*. (See generally Joubert (ed) Law of South Africa vol 8 paras 47-9). The Shell case supra was an instance of such a *novus actus interveniens*."

From the above case one has to determine whether the disclosure of information by the taxpayer was the legal, as opposed to the factual

cause for the reward, in question. The factual causes of the reward would include the commission of the crime, the arrest and subsequent conviction of the offenders.

It is submitted that, the events which followed upon the disclosure of the information were the decisive factors leading to the receipt of the reward by the taxpayer. It is further submitted that the factual causes, as stated above, amounts to a *novus actus interveniens*, which has the effect that the information so disclosed, becomes a "historical antecedent or background feature".[15]

If one thus agrees to the submission postulated above, then the reward paid to the taxpayer is of a fortuitous nature, or the quality of a testimonial or accolade rather than a payment for services rendered.[16]

CONCLUSION

The disclosure of information by the taxpayer in the case scenario will only be taxable if it falls within the ambit of para (c) of the definition of "gross income". However, notwithstanding the wording of this provision, it is submitted that a unilateral act by

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[15] Shell Southern Africa Pension Fund case (supra).

[16] Stander v Commissioner for Inland Revenue (supra).

any given person, cannot per se amount to a "service rendered".[17] Furthermore, the reward of R200 000 received by the taxpayer must have been received "in respect of" the service rendered. On analysis of the relevant cases and authorities cited above, I agree to the submission that the information disclosed by the taxpayer did not constitute a "service rendered" to the police, nor was it the legal cause of the reward received by him. The reward was therefore not received "in respect of services rendered" and in not taxable in the hands of the taxpayer.

[17] ITC 779 (supra) at 327.