

In the Supreme Court of South Africa
In die Hooggeregshof van Suid-Afrika

(*Appellate* Provincial Division.)
(*Provisiale Afdeling*).

Appeal in Civil Case.
Appel in Siviele Saak.

COMMISSIONER for INLAND REVENUE Appellant,

versus

LOUIS ZINN ORGANISATION (PTY) LTD. Respondent.

Appellant's Attorney *Stander* Respondent's Attorney *H. L. Israel*
Prokureur vir Appellant Prokureur vir Respondent

Appellant's Advocate *A. E. Ellinger, QC* Respondent's Advocate *D. Gould, QC*
Advokaat vir Appellant Advokaat vir Respondent

Set down for hearing on *Monday, 26th Sept, 1958.*
Op die rol geplaas vir verhoor op

1.3.5.8.10.11
(A)

9.45 - 12.50
+ 2.15 - 4.30 - CAY

JUDGMENT : TUESDAY, 30th SEPTEMBER, 1958.

Appeal allowed with Costs and the Order
of the Special Court is altered to one of
upholding the Commissioner's assessment.

Concurre: Schreiner, A.C.J., Steyn, Beyers, Pica (Acrg.) et Smit (Acrg.)
JJA.

Nederlandsch.

REGISTRAR.
30/9/58.

Record

IN THE SUPREME COURT OF SOUTH AFRICA

(Appellate Division)

In the matter between :-

THE COMMISSIONER FOR INLAND REVENUE Appellant

and

THE LOUIS ZINN ORGANISATION (PTY) LTD. Respondent

Coram: Schreiner A.C.J., Steyn, Beyers, ~~Ogilvie Thompson~~ J.J.A.
at Price A.J.A. et Smut, A.J.A.

Heard: 26th September, 1958. Delivered: 30 - 9 - 1958

J U D G M E N T

SCHREINER A.C.J.:— This is an appeal by way of stated case brought by the Commissioner for Inland Revenue against a decision of a special court for hearing income tax appeals; the parties have lodged their consent to a direct appeal to this Court in terms of section 81 (1) (b) of Act 31 of 1941, which I shall refer to as "the Act".

The respondent, a company dealing in men's clothing, appealed against "an assessment of assessed loss" incurred in the year ended 30th June 1954. The matter turns on the application to the facts of certain provisions of the Act. So far as material these provisions read:—

"7./.....

"7. 'Gross income' means the total amount whether in cash or otherwise received by or accrued to or in favour of any person, excluding such receipts or accruals of a capital nature as are not receipts or accruals referred to in paragraph (a) to (h) hereunder, in any year or period assessable under this Chapter.....and includes the following:-

(h) any amounts which in terms of other sections of this Act are specifically required to be included in the taxpayer's income.....

11(1) For the purpose of determining the taxable income derived by any person from carrying on any trade in the Union there shall be deducted or set off against the income of such person so derived.....the amounts set out in this section.

(2)The deductions allowed shall be -

(a) expenditure and losses actually incurred in the Union in the production of the income, provided such expenditure and losses are not of a capital nature
.....

(3) There shall be set off -

(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, provided that

(i) no person, whose estate has been.....sequestered shall, unless the order of sequestration has been set aside, be entitled to carry forward any assessed loss incurred prior to the date of sequestration;

(ii)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/.....

or extinguished, provided such liabilities arose in the ordinary course of trade;

-
(b) any assessed loss incurred by the taxpayer during the same year of assessment in carrying on in the Union any other trade.....

For the purposes of this subsection "assessed loss" means any amount, as established to the satisfaction of the Commissioner, by which the deductions admissible under this section exceed the income in respect of which they are so admissible

- (4) (a) There shall be included in the taxpayer's income all amounts allowed to be deducted or set off under the provisions of subsection (2).....or subsection (3)....., whether in the current or any previous year of assessment, which have been recovered or recouped during the current year of assessment. "

From the special case it appears that the following facts were admitted :-

During the year ended 30th June 1954 the respondent incurred a trading loss of £105,401 which it returned as its loss for the year for income tax purposes. In its Balance Sheet as at the 30th June 1954 the respondent showed the following item -

"Gain on compromise with Trade Creditors - £93,755"

The/.....

The last-mentioned sum arose out of a compromise entered into by the respondent with its creditors in March 1954, whereby the creditors accepted 6/- in the pound in full satisfaction of their claims. The amount of those claims was originally £133,936, incurred in the purchase of stock-in-trade in the year ended 30th June 1954 and previous years. The amount of £93,755 represents the difference between the amount of £133,936 and what was due to the creditors under the compromise, namely, £40, 181. The exact allocation of the purchases of stock-in-trade as between the various years was not put before the special court. The amounts of such purchases relating to years prior to the year ended 30th June 1954 were allowed to be deducted under section 11(2)(a) in the assessments raised on the respondent for those years. The amounts of such purchases relating to the year ended 30th June 1954 were taken into computation by the respondent in arriving at the abovementioned loss of £105,401.

The Commissioner, in determining the respondent's assessed loss for the year ended 30th June 1954, took into account the abovementioned amount of £93,755 and determined the assessed loss at £11,646, which was arrived at and described in the assessment notice as follows :-

"Loss/.....

"Loss as returned £105, 401

Less: Balance of assessed loss

reduced in terms of pro-

viso (ii) to section 11(3)

(a) or, alternatively, in-

cluded in income, in terms of

section 11(4) of the Act. £ 93,755

£ 11,646 "

The respondent lodged objection and appeal against this assessment, claiming and contending before the special court that its loss ranking for set off against income which might accrue in future years was £105, 401 and not £11, 646, in that

- (1) the loss of £105,401 was not to be reduced by £ 93,755 since the latter amount was a benefit which accrued to the respondent during the same year of assessment as that in which the loss of £105, 401 was incurred;
- (2) the loss of £105, 401 was not a balance of assessed loss incurred in any previous year of assessment which had been carried forward from the preceding year of assessment and accordingly that section 11(3) (a) (ii) had no application ;
- (3) the Commissioner was not entitled to include the £93,755 in the respondent's income for the year under review because

the/.....

the sum did not represent either the recovery or the recoupment of an amount allowed to be deducted under section 11(2) or allowed to be set off under section 11(3) either in the year under review or in any previous year; and

(4) the £93, 755 constituted a gain of a capital nature and had no bearing on the results of the respondent's trading operations.

The Commissioner contended before the special court

(1) that the £93, 755 was a benefit not of a capital nature;

(2) that the provisions of section 11(3) (a) (ii) are tautologous in regard to the provisions of section 11(4) (a) which is the dominant section and that the £93, 755 was a "recoupment" in terms of section 11(4) (a); and

(3) alternatively to (2) that, for purposes of determining the expenditure allowable to the respondent under section

11(2) (a) in respect of purchases made during the year ended 30th June 1954, such portion of the sum of £93,755 as re-

lates to such purchases should be brought to account in reduction of the full purchase price as originally agreed, and

that the case should be referred back to the Commissioner for determination of such portion and re-assessment accordingly.

The/.....

The reasons why the special court held that the Commissioner had incorrectly taken the sum of £93,755 into account in determining the respondent's loss for the year "ended 30th June 1954" and set the assessment aside appears from the judgment of the learned President of the court which is annexed to the special case. After setting out section 11(3) (a) (ii) the judgment proceeds :-

"This sub-section, it will be seen, makes specific provision for the deduction of the amount of a benefit of this nature from an assessed loss in a prior year which has been brought forward. There is no provision for the deduction of such an amount from a loss in the current year.

"I think it is impossible to read in that section any implication that any such amount can be deducted from a loss in the current year. The very clear wording of the section limits the deduction to one from an assessed loss brought forward from a prior year. Quite clearly therefore the gain on compromise under consideration in the present case could not be deducted from the loss for the year ending 30th June 1954 under that sub-section.

"The fact that there has to be specific provision in the sub-section for the deduction of the amount of such a benefit seems to imply that the Legislature has recognised that ordinarily such an amount would not be income and has to be made income by virtue of a specific statutory provision therefor.

"It is accordingly clear that in order to bring this amount into account in the year of assessment the Commissioner must contend as has been contended on his behalf that this amount was a recoupment or recovery in terms of section 11(4)(a)

"In my view this receipt of a capital benefit if it can be so termed, can never be a recovery or recoupment within the ordinary/.....

ordinary meaning of those terms. The trader has by an act of grace been allowed a reduction of a liability and unless there were some statutory authority for reading the words otherwise it seems to me that the trader has not been recouped nor has he recovered any amount. "

~~"In my view this receipt of a capital benefit, if it can be so termed, can never be a recovery or recoupment within the ordinary meaning of those terms. The trader has by an act of grace been allowed a reduction of a liability and unless there were some statutory authority for reading the words otherwise it seems to me that the trader has not been recouped nor has he recovered any amount. "~~

In this Court the Commissioner, in the first instance relied solely on section 11(4)(a) as the basis for his claim that the full amount of £93,755 had to be taken into account. As in the case presented to the special court, section 11(3)(a)(ii) was treated as a special example of recovery or recoupment, overlapping section 11(4)(a) and being for that reason apparently unnecessary. This line of argument assumed, as did the judgment of the President of the special court, that the reduction of the balance of assessed loss provided for in section 11(3)(a)(ii) is a reduction of a balance already determined and available for use in the tax year in which what may be called the compromise benefit comes into existence. On that view the amount of the compromise benefit operates by a form of counter-set-off. to

reduce/.....

reduce the balance of assessed loss carried forward from the previous year into the tax year. If the compromise benefit is large enough it will extinguish the balance of assessed loss so brought forward. If not it will reduce the balance of assessed loss available for setting off in the future. But since on this view the compromise benefit only operates to reduce by counter-set-off a balance of assessed loss already determined for and available for use in the tax year, i.e. the year during which the compromise benefit arises, section 11(3)(a)(ii) has no application in the present case, because there was no balance of assessed loss already determined and available for use in the year ending 30th June 1954. Since no such balance had been carried forward from the year ending 30th June 1953, there was nothing for the compromise benefit of £93,755 to be set against. The loss of £105,401, being the assessed loss for the year ending 30th June 1954, had accordingly to go forward, unreduced, to be available in the first year in which a working profit was made and in subsequent years until exhausted.

This view produces the anomaly that if the compromise benefit were to arise say, in June 1954 it would not go to reduce the £105,401 but if it were to arise/.....

arise in July 1954 it would reduce it. The view also raises a difficulty ^{co-}in relating section 11(3)(a)(ii) and section 11(4)(a). These provisions made their first appearance in our income tax legislation in ~~Act 51 of~~ ^{the Act} 1941, and were presumably part of one plan. It is improbable that if, as the Commissioner contends, section 11(4)(a) covers compromise benefits, which must be included in the taxpayer's income, since, in the normal case at any rate they amount to recoveries or recoupments of expenditure deducted under section 11(2)(a), Parliament would nevertheless enact a provision in the form of section 11(3)(a)(ii), to cover the particular case of reducing the balance of assessed loss. But counsel for the respondent also found it difficult on his submissions to fit section 11(3)(a)(ii) comfortably into the Act. In his submission, despite ^{the} ~~its~~ wide language ^{of} ~~that provision~~ section 11(4)(a) ^a was intended to have a narrow operation; it would not, for instance, apply to transactions which resulted in the ex post facto diminution of expenditure deducted under section 11(²~~4~~)(a). Some such diminutions would be taken into account, but not under ^{section 11(4)(a)} ~~the last-mentioned provision~~. But, so it was argued, because the language of section 11(4)(a) might mistakenly be read as covering compromise benefits having the effect of diminishing expenditure under section 11(2)(a), -

Parliament introduced section 11(3)(a)(ii) in order to make it clear that compromise benefits were only to have that limited operation to the disadvantage of the taxpayer. This seems to me to be a very awkward scheme for Parliament to have devised - to make section 11(4)(a) dangerously wide and loose and then ^{to} put in another provision, section 11(3)(a)(ii), which without reference to section 11(4)(a) was to have the effect of cutting down its possible operation. It may be added that on the submission of the respondent's counsel there remains the anomaly referred to above, which could only lead to the conclusion that Parliament had been guilty of a casus omissus. No doubt such oversights, just like tautology, occur in Acts of Parliament but a construction which avoids them is to be preferred to one that does not.

It seems to me that these difficulties are largely if not entirely removed if section 11(3)(a)(ii) is read with due regard to the scheme of relief provided by subsection (3) and the steps required to give effect to it. 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/.....

forward into the next year. There may have been a profit in the tax year but not large enough to obliterate the balance of assessed loss carried over from the previous year. Then the new balance of assessed loss will be smaller than the previous one. If there has been a working loss in the tax year the balance to go forward will be increased. If there has been no previous balance the assessed loss in the tax year will be the balance of assessed loss carried forward. The point to keep in mind is that, although at the stage where it is to be used, i.e. when it is to be set off against a profit, a balance of assessed loss looks back to the past, at the stage when it is being determined i.e. when its amount is being calculated it looks forward to the future when it will be used. At the determination stage it is being prepared for future use and it has then no effect on the taxpayer's liability in respect of the tax year for which the relative notice of assessment is issued.

It is into this scheme that section 11(3)(a)(ii) is introduced. The question arises whether when it provides that "the balance of assessed loss shall be reduced" the paragraph is referring to the stage of application or to the stage of determination. Looking only at these words themselves/.....

themselves there is little to choose between the two points of view. For what may be called the application view point it may be said that you can only reduce something that already exists, and that you have no balance of assessed loss until it has been determined. On the other hand it may be said that the word "reduce" is more appropriate to the ^edetermination stage, since once the balance of assessed loss is determined you cannot really reduce it - you can only reduce its effect by counteracting it with another amount.

The view that the reducing relates to the stage when the balance of assessed loss is being determined avoids the abovementioned anomaly. In determining the balance of assessed loss^s to be carried forward for use in the year ending 30th June 1955 and thereafter, what would otherwise be the amount of the balance is reduced by the compromise benefit of £93,755. That would be the position if the compromise benefit arose in June 1954. If it arose in July 1954 the balance of assessed loss available for use in the year ending 30th June 1955, i.e. the balance appearing in the notice of assessment in respect of the year ending 30th June 1954, would be £105,401. This would be modified, for the purposes of determining the balance of assessed loss to be carried/.....

-ried forward into the year ending 30th June 1956, by the trading loss or profit of the year ending 30th June 1955. If there was a profit in that year large enough to wipe out the whole £105,401, the £93,755 would, so far as section 11(3) (a) (ii) is concerned, disappear from the calculations, since it would not be needed; there would be no balance of assessed loss~~es~~ to be carried forward into the year ending 30th June 1956 for it to reduce. But if there were an assessed loss in the year ending 30th June 1955 or a profit of less than £105,401, the £93,755 would operate to reduce or extinguish the balance of assessed loss to be carried forward into the year ending 30th June 1956.

This view also avoids the difficulty of relating section 11(3)(a)(ii) to section 11(4)(a). The reason for mentioning subsection (3) in section 11(4)(a) is not very clear. It seems possible that the explanation is to be found in ^{some portion of sub-section (3) other} ~~section 11(3)(a), which has no precise corres-~~ ^{than} ~~ponding to~~ section 11(3)(a)(ii). But in any event such difficulty as there is in accounting for the mention of subsection (3) appears to be common to all views considered in the course of the ~~judicial~~ argument.

In the light of the above con-

siderations/.....

-siderations it seems to me that the correct view is that the reducing of the balance of assessed loss referred to in section 11(3)(a)(ii) takes place at the stage when that balance is determined, for use in the future. It follows that the Commissioner was right in deducting the £93,755 from the £105,401 and in determining the balance at the figure of £11,6⁴~~2~~6. This view makes it unnecessary to pass judgment upon the several alternative contentions advanced on behalf of the Commissioner.

It was argued on behalf of the respondent that if the appeal were allowed for ^{the} reasons given above the Commissioner should be deprived of his costs because the point was not taken by him until it was raised from the Bench; indeed, we were given to understand by the respondent's counsel that it was actually abandoned before the special court. But there is no reason to suppose that the respondent would not have fought the appeal had the point been supported by the Commissioner throughout. There is, ~~however~~ ^{moreover}, the ~~fact~~ ^{fact} that the argument based on section 11(4)(a) has not been rejected as invalid. The costs must therefore follow the event.

The appeal is allowed with costs and the order of the special court is altered to one upholding the Commissioner's assessment.

Steyn, J.A.
Beyers, J.A.
~~Ogilvie Thompson, J.A.~~
Price, A.J.A.
Smill, A.J.A.

Concur.

J.D. Schreiner
30.9.58

J.W.S.
3.11.58