G.P.-S.33967—1968-69—1,000.

J. 219.

63/70

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

(Provincial Division.)
(APPELLATE Provinsiale Afdeling.)

Appeal in Civil Case.
Appèl in Siviele Saak.

SECRETARY FOR INLAND REVENUE *Appellant,*

versus

F. ROSEN *Respondent*

Appellant's Attorney
Prokureur vir Appellant Dep. S.A. (Bmf tn.)

Respondent's Attorney
Prokureur vir Respondent Claude Reid & Haylett

Appellant's Advocate
Advokaat vir Appellant

Respondent's Advocate
Advokaat vir Respondent

Set down for hearing on
Op die rol geplaas vir verhoor op 24-8-70

2.4.7 8.10

(S. I. T. C.)

Appeal dismissed with costs including the costs relating to two counsel.

REGISTRAR, APPEAL COURT,
GRIFFIER, APPÈLHOF,
BLOEMFONTEIN.

Writ issued Lasbrief uitgereik	Bills Taxed.—Kosterekenings Getakseer.		
	Date. Datum.	Amount. Bedrag.	Initials. Paraaf.
Date and initials Datum en paraaf			

IN THE SUPREME COURT OF SOUTH AFRICA.

APPELLATE DIVISION.

In the matter between:

SECRETARY FOR INLAND REVENUE ..... APPELLANT.

AND

F. ROSEN ..... RESPONDENT.

Coram : Ogilvie Thompson, Holmes, Jansen, Trollip, JJ.A.

et Muller, A.J.A.

Heard : 24 August 1970. Delivered : 24 September '70.

J U D G M E N T .

TROLLIP, J.A. :-

This appeal concerns the liability to normal tax of a non-resident taxpayer for the income received by or accruing to his wife, Mrs. Selma Rosen (born Schneier), from a trust administered in the Republic, during the year of assessment ended 28 February 1965.

The problems involved arise in this way. On 17 August 1939 Mrs. Rosen's late father, desirous of making provision for her during her lifetime, created a

trust ..... /2.

trust in Johannesburg. According to the trust deed, he donated to and vested in trustees a number of shares in various companies and also a debt owed to him by one of the companies (referred to as "the Company" in the deed). Paragraph 2 of the trust deed provided that the dividends declared by the Company should be left with it until its indebtedness under a certain bond had been liquidated. Paragraph 3 reads:

> " Subject to the right of the Company to retain the dividends as provided in Clause 2 hereof, the Trustees shall from time to time collect, get in, and receive all dividends, interest and other income from the said Shares and/or the said Debt and/or generally from any Assets for the time being of the Trust Estate (all hereinafter referred to as "the INCOME"), and shall pay out of such income from time to time until the said SELMA SCHNEIER reaches majority, such sum or sums as will be necessary or required properly

to ..... /3

to maintain and educate the said SELMA SCHNEIER. When the said SELMA SCHNEIER reaches majority, the Trustees shall pay out of such income, not later than the 10th day of each and every month, commencing from the 10th day of the month following the date the said SELMA SCHNEIER reaches majority, unto the said SELMA SCHNEIER during the term of her natural life, a sum of £25.0.0. (TWENTY FIVE POUNDS) per month. .....

All income over and above the payments which the Trustees are obliged or entitled to make in terms hereof shall be added to and shall form part of the Capital Assets of the Trust, subject, however, to the provisions of Paragraph 15".

Paragraphs 5 and 7 empower the Trustees to realize investments and to re-invest the funds or invest other available funds of the trust in shares or other assets with the sanction or on the direction of the donor or his executors and administrators and Mrs. Rosen. Paragraph 6

makes ..... /4.

makes elaborate provision for the disposal of the capital of the trust on Mrs. Rosen's death to her children, or failing them, to other beneficiaries. The effect of paragraphs 1 and 5 is that the shares of the trust are to be registered in the name of the trustees, but according to paragraph 8 the latter are obliged to vote in respect of those shares in the manner directed by Mrs. Rosen. Paragraphs 3 and 10 provide for the payment of remuneration to the trustees and contemplate the trustees' having to pay other administrative expenses out of the trust income. Paragraphs 14 and 15 are of importance in this appeal. They read:

"14. The amount of the monthly payment to be made in terms of Paragraph 3, may from time to time be increased to such amount as the Trustees and the DONOR in writing agree, or in the event of the death of the DONOR, as the Trustees and the DONOR'S Executors and Administrators in writing agree.

15. The Trustees and the DONOR or the Trustees and the DONOR'S Executors and Administrators may:-

(a) Increase the amount of the monthly payment for any particular month or months and then revert

to the monthly payment of £25.0.0. or to such amount as the said monthly payment of £25.0.0. may have been increased to in terms of Paragraph 14.

(b) From time to time make payments to the said SELMA SCHNEIER of lump sums in addition to the monthly payment provided they be made from accumulated income."

During the year of assessment the income received by the trust was approximately R7735, of which about R4684 was from dividends and the balance from interest. An amount of R792 was brought forward from the previous year. It possibly represented accumulated income. Out of such income R7200 was paid by the trustees to Mrs. Rosen. During that year she and her husband, the taxpayer, were ordinarily resident in England and were not ordinarily resident nor carried on any business in South Africa. The Secretary, the appellant in this appeal, included the whole of the R7200 in the taxpayer's income, as being an amount paid to Mrs. Rosen

by ..... /6.

by way of an annuity, and assessed him accordingly.

Following on an objection and appeal by the taxpayer against that assessment, the Special Court (a) accepted that R600 of the R7200, being the R50 per month payable in terms of paragraph 3 of the trust deed, was an annuity, since that was common cause; (b) held that none of the remaining R6600 constituted an annuity in terms of section 10(2)(b) of the Income Tax Act, No. 58 of 1962; (c) held by implication that consequently so much of the R6600 as was derived from dividends was exempt from normal tax by section 10(1)(k)(ii); (d) held that so much of the R600 as was derived from dividends was subject to the special deduction mentioned in section 19(3); and (e) set aside the assessment and referred the matter back to the Secretary to re-assess the taxpayer in accordance with its decision. The Secretary has now appealed to this Court against that decision.

As an introduction to the consideration of the problems involved I first refer to the main, relevant provisions of the Act. Section 5 levies normal tax on a

person's ..... /7.

person's "taxable income". "Taxable income" means "gross income" less any amounts exempted from normal tax and deductible or set-off under Part 1 of Chapter II of the Act. "Gross income" is defined in Section 1 to include "in the case of any person" (i.e. irrespective of where he resides so long as the source of the income is in the Republic) "(a) any amount received or accrued by way of annuity" and "(k) any amount received or accrued by way of dividends ...". However, section 10(1)(k)(ii), which falls within Part 1 of Chapter II of the Act, exempts from normal tax "dividends received by or accrued to or in favour of any person (other than a company) not ordinarily resident nor carrying on business in the Republic". But that exemption is qualified by section 10(2)(b), which says that it shall not apply "in respect of any portion of an annuity". Section 19, as amended, which also falls within the same Part and Chapter of the Act, provides for deductions from income derived from dividends. Sub-section (3) thereof permits a percentage of the dividends, determined by a specified

scale ..... /8.

scale, to be deducted from "income in the form of dividends derived by any person other than a company".

The issues raised before us can be summarized thus -

1. Did any part of the R7200 constitute "dividends received by or accrued to or in favour of" Mrs. Rosen in terms of section 10(1)(k)(ii) ?

   If no, the exemption in that section does not apply, the amount thus remains taxable income in her hands, and the deduction in section 19(3) could not be made since, ex hypothesi, she would not have derived any of that income "in the form of dividends", as postulated by that section. The appeal must then succeed.

   If yes, the following further issues arise.

2. Did such dividends form "any portion of an annuity" in terms of section 10(2)(b) ?

   If no, cadit quaestio: the appeal would fail.

   If yes, ~~that particular~~ such dividend - portion of the annuity would be excluded from the above exemption and remain as taxable income in Mrs. Rosen's hands.

/9.

The final issue would then be as follows.

3. Did the dividend-portion of the annuity qualify for the deduction in section 19(3) ?

If yes, the appeal would fail; if no, the appeal would succeed to that extent.

Now although that is the logical sequence for summarizing the issues, I find it more convenient to determine at the outset whether any part of the R7200 constituted an annuity, since that involves an analysis of the facts and an interpretation of the trust deed which will facilitate the discussion of the other issues.

It was also common cause before us that the R600 of the R7200 was an annuity. The reason was obviously that, in terms of paragraph 3 read with paragraph 15 of the trust deed, the trustees were obliged to pay and Mrs. Rosen was entitled to receive at least that amount every year during her lifetime at the rate of R50 per month, the donor having donated sufficient assets in trust to ensure that the income therefrom will always be available for that purpose.

As ..... /10.

As to the R6600, paragraph 14 of the trust deed provides that the annuity can be increased by agreement in writing between the trustees and the administrators. Subject to the required income being always available (about which the trustees and administrators would satisfy themselves before agreeing to the increase), the increased amount would also have to be paid every year during her lifetime; the trustees or administrators would have no right or discretion unilaterally to discontinue or reduce it. Paragraph 15(a) makes that clear. Hence the increased amount would also be an annuity. On the other hand, paragraph 15(a) gives the trustees and administrators a discretion to increase the monthly payments to Mrs. Rosen for any particular month or months and then to revert to the normal monthly amount payable under paragraph 3 or 14. Such temporary increased payments would not in my view constitute an annuity, or form part of the annuity under paragraphs 3 and 14. They would simply be intermittent, discretionary distributions of the trust income. Hence they would lack ~~"this"~~ "the element of necessary

annual ..... /11.

annual recurrence" inherent in an annuity - the trustees' obligation to continue paying them and Mrs. Rosen's right to continue receiving them annually (Secretary for Inland Revenue v. Watermeyer 1965(4) S.A. 431 (A) at p. 437 B-C; L.Feldman Ltd. v. Secretary for Inland Revenue 1969 (3) S.A. 424 (A) at p. 429 E-F). A fortiori, any lump sums paid to Mrs. Rosen from time to time by the trustees out of accumulated income under paragraph 15 (b) of the trust deed would not constitute or form part of any annuity. They would even more obviously be intermittent, discretionary distributions of accumulated income that the trustees would not be obliged to make or continue making nor Mrs. Rosen be entitled to receive or continue receiving. The question is therefore whether the R6600 was paid in terms of paragraph 14 or 15 of the trust deed.

According to the admitted or proved facts recorded in paragraph 3(10) of the stated case, the administrators wrote to the trustees on 11 December 1964 asking and authorising them "in terms of clause 14 of the Trust Deed..

to ..... /12.

... to increase the monthly payment to Mrs. Selma Rosen from R50 per month to R600 per month with effect from January, 1965", and "in order to give effect to the increase for the year ended on 28th February 1965 ..... to make a special payment of R5,500" to her. (The italics there and hereafter are mine.) The trustees' written reply thereto, if any, is not recorded, but according to sub-paragraph (11) of the stated case one of the administrators, Mr. Schwartz, wrote to the Receiver of Revenue on 31 December 1964 saying: "The Trustees and the Administrators ..... have now decided to pay to the beneficiary (Mrs. Rosen), out of the Trust income, a lump sum, and in addition thereto a monthly amount of R600 in the future". The stated case then records in sub-paragraph (14)(b) the factual findings that the R7200 paid to Mrs. Rosen comprised (i) R500, being R50 per month for the first ten months of the year ended 28 February 1965, (ii) R1200, being "R600 in each of the months January and February, 1965," and (iii) R5,500 "being a special payment made in January, 1965, being a lump sum equivalent to R550 per month in respect

of ..... /13.

of the first ten months of the said year". The sub-paragraph proceeds: "The payments referred to in items (ii) and (iii) above were made by the Trustees pursuant to their accepting the proposals of the Administrators set out in sub-paragraph (10) hereof. The object of the special payment referred to in item (iii) was to treat Mrs. Rosen as if she had received R600 a month for the whole of the said year".

On those facts Mr. O'Donovan, for the Secretary, contended that the R1200 and R5500 must have been paid out under paragraph 14 of the trust deed, since that paragraph was specifically mentioned in the administrators' proposals of 11 December 1964, which, according to sub-paragraph 14(b) of the stated case, the trustees had accepted and in pursuance of which those amounts were paid out. Hence, so he argued, those amounts were part of Mrs. Rosen's annuity for the year of assessment.

That approach is in my view not correct. That the trustees did accept the monetary proposals of the

administrators ..... /14.

administrators' is clear. I do not think that the finding to that effect in sub-paragraph (14)(b) means anything more than that. It does not connote that the trustees also thereby agreed specifically that those payments should be made in pursuance of paragraph 14 rather than paragraph 15 of the trust deed. It does not say so expressly, and any construction or inference that it bears that connotation would be so wholly contrary to other parts of the stated case and irreconcilably inconsistent with the relevant findings in the judgment of the Special Court (to be mentioned presently) that it could not prevail (W.F.Johnstone & Co. Ltd. v. C.I.R. 1951 (2) S.A.283 (A) at p. 290 A-D; cf. Goodrick v. C.I.R. 1959 (3) S.A. 523 (A) at p. 529 G-H). For such a connotation would mean that the trustees had agreed to being bound to pay and Mrs. Rosen being entitled to receive R600 per month for the rest of her life, and that is directly contrary to the factual findings recorded in the very next part of sub-paragraph (14) of the stated case. It reads: "There was no agreement between the Administrators and Trustees whereby

the ..... /15.

the latter were committed to continue paying Mrs. Rosen R600 per month. At the time when the Trustees accepted the Administra-tors' proposals set out in sub-paragraph (10) hereof, it was understood that R600 per month would be paid as long as the Administrators and Trustees thought it should be paid".

Furthermore, according to the stated case Mr. Schwartz wrote to the Receiver on 10 September 1965 and 22 February 1966 explaining why less than R600 per month was then being paid to Mrs. Rosen, namely, that the trustees had acceded to the request to pay more than the R50 per month on the basis that their decision was not permanent and could in their discretion be changed at any time. That conformed too with what he had previously said in his letter of 4 February 1965 to the Receiver. And his evidence before the Special Court must have been to the same effect, for the learned Judge said in his judgment:

> "The evidence was that the decision of the Administrators to increase the payments ... for the year ended 28th February, 1965, was a purely discretionary .....

/16.

ary one. It was taken only one month before the end of the tax year and ... had to be substantially revised in March, 1965. Their decision did not entitle the appellant's wife to continue receiving R600 per month in the succeeding years".

That that evidence was accepted by the Special Court is shown by this subsequent passage in the judgment:

"In the present case (Mrs. Rosen) was not entitled to anything more that R50 per month in terms of clause 3 of the Deed of Trust. The decision to increase the amount for the year ended 28th February, 1965, was purely a discretionary one. It did not entitle (her) to continue receiving R600 per month ..... ".

Those facts and findings establish that the administrators and trustees did not agree that the increase above R50 in the monthly payments to Mrs. Rosen would be permanent, but, on the contrary, that they had decided to retain a discretion to discontinue or reduce

that ..... /17.

that increase at any time thereafter. Consequently, despite the mention of paragraph 14 of the trust deed in the administrators' letter of 11 December 1964, the stated case, read as a whole, and the judgment of the Special Court show that the decision of the trustees and administrators must have been taken under paragraph 15(a) and not paragraph 14 thereof. That conclusion applies not only to the payments of R550 for each of January and February 1965 but also to the R5500 paid to Mrs. Rosen in January 1965, for that was intended and was expressed to be the R550 per month for the preceding ten months.

It is also appropriate here to express my view that the R5500 did not fall under paragraph 15(b) of the trust deed. It is true that in the correspondence and the factual findings it is referred to as "a special payment" and "a lump sum", but it was clearly equated to and dealt with by the stated case and Special Court (see excerpts above) as monthly payments during that year. Moreover, it was not paid out of accumulated income but out of current income for the year of assessment (except

possibly ..... /18

possibly to the small extent that it might have been drawn proportionately from the R792 carried forward from the previous year). This view is relevant to the first issue, as will presently appear.

It follows that I agree with the conclusion of the Special Court that only the R600 of the R7200 constituted an annuity in the hands of Mrs. Rosen.

I turn now to the first issue: whether any part of the R7200 constituted "dividends" in the hands of Mrs. Rosen in terms of section 10(1)(k)(ii). As most of the trust income for the year of assessment comprised dividends, and the payment of R7200 almost exhausted the trust income, it can be inferred that the latter was drawn mostly, or, at any rate, substantially from those dividends. But, of course, those dividends were paid by the companies not to Mrs. Rosen but to the trustees as the registered shareholders. The inquiry therefore is whether in terms of the trust deed and provisions of the Act they retained their identity or character as dividends in her hands for the purpose of that

section ..... /19.

section.

Before proceeding with that inquiry I should mention that the Special Court in its judgment and counsel in their arguments most industriously referred to certain provisions in the prior Income Tax Acts and their history. Consequently there is need, I think, to emphasise here that it is the present, the 1962 Act, that governs the inquiry and that the previous legislation cannot be invoked to aid in its construction unless the relevant provisions are ambiguous (R v. von Zell 1953 (4) S.A. 552 (A) at p. 558 F-H) or unless it is merely to confirm an interpretation already achieved. But I hasten to add that such emphasis is not due to any oversight in that respect by the Special Court or counsel (indeed Mr. O'Donovan put his argument on that very basis) but merely to explain why I shall start with the present Act and confine myself almost entirely to its provisions.

Now, as to the 1962 Act. "Dividend" is elaborately defined in section 1, but it suffices to say that

it ..... /20.

it means "any amount distributed by a company ... to its shareholders" subject to certain exclusions irrelevant here. It consequently includes dividends ordinarily paid out of a company's profits or income. "Company" is defined to include, inter alia, a company in the ordinary sense of the word. The definition of "shareholder" is important. In so far as it is relevant here it means

> "in relation to any company .... the registered shareholder in respect of any share, except that where some person other than the registered shareholder is entitled, whether by virtue of any provision in the memorandum or articles of association of the company or under the terms of any agreement or contract, or otherwise, to all or part of the benefit of the rights of participation in the profits or income attaching to the share so registered, such other person shall, to the extent that he is entitled to such benefit, also be deemed to be a shareholder".

The ..... /21.

The broad explanation of that definition is this. The registered shareholders of a company are usually entitled to "the rights of participation in (its) profits or income attaching to the share so registered". Consequently dividends declared by the company out of its profits or income are normally payable to them. If, however, someone else is legally entitled by agreement, etc., to all or part of the dividends received by a registered shareholder, he is also deemed to be a shareholder to the extent of his entitlement for all purposes of the Act, except where the context indicates otherwise. Whether the beneficiary's legal entitlement is such as to deem him a shareholder must, of course, depend upon the terms of the agreement, etc., creating it. It arises not infrequently under an agreement of trust, as for example, in Bell's Trust v. C.I.R. 1948 (3) S.A. 480 (A). That was a decision on a similar definition of "shareholder" in section 33 (4) of the Income Tax Act, No. 31 of 1941. This Court held that the legal entitlement of a beneficiary under a trust agreement to receive from

the ..... /22.

the trustee, the registered shareholder, a proportionate part of the dividends that he had received from the company concerned rendered the beneficiary pro tanto a "deemed shareholder". The relevant facts were that 94,000 shares of a certain private company were vested in trustees who were obliged in terms of the trust deed to pay the five children of the donor "all dividends and bonuses and other moneys which shall accrue on the said shares". The minors' share of such income was, however, to be retained by the trustees until each attained majority. There was a gift over of the corpus to the grandchildren on the death of all the children. At page 490 Centlivres, J.A., said:

> "I am therefore of opinion, that under the definition of 'shareholder', the registered shareholder is always a shareholder within the meaning of that definition and that some one else who is entitled to all or part of the benefit of the rights of participation in profits or income attaching to the shares may also be a shareholder. From this

it ..... /23

it follows that in the present case both the Trust, which is the registered shareholder, and the major children are shareholders within the meaning of the definition. The major children are such because they are entitled to part of the benefit of rights of participation in the profits or income attaching to 94,000 shares registered in the name of the Trust".

The next inquiry is whether the amount that a deemed shareholder so receives from the registered shareholder still constitutes in his hands a "dividend" as defined, i.e., "an amount distributed by a company to its shareholders". Now the word "shareholders" there must be given its defined meaning. It was not contended that the context indicates otherwise. "Dividend" would thus include an amount distributed out of the company's profits or income not only to its registered but also to its deemed shareholders. It follows therefore that such of the dividends paid by a company to a registered shareholder as are passed on by him

to ..... /24.

to a deemed shareholder by virtue of the latter's legal entitlement thereto, must also be regarded as having been distributed by the company through the registered shareholder to him. Consequently they also constitute "dividends" as defined in his hands.

Now, "dividends" in section 10(1)(k)(ii) must also be given its defined meaning. Again it was not contended that the context indicates otherwise. Hence, the amounts so received by the deemed shareholder will constitute "dividends received by or accrued to or in favour of" him. The language there used is sufficiently clear and comprehensive to cover that kind of receipt and recipient. Those dividends will thus be exempt from normal tax under the section. The exclusion of an annuity from that exemption by section 10(2)(b) confirms that conclusion. For it accepts that an annuity can constitute "dividends" in the annuitant's hands, and, since a company distributes dividends and not annuities, that can only happen through the registered shareholder's paying an annuity out of dividends received

by ..... /25

by him from a company to a deemed shareholder in terms of his legal entitlement.

In effect the legislature in those provisions has adopted a principle that can be conveniently termed the conduit principle: the registered shareholder is regarded as a mere conduit-pipe for passing the dividends on to the deemed shareholder, the true recipient of them, in whose hands they consequently retain their identity and character as dividends. The function of the principle is mostly apposite to trust cases, the mere interposition of the trustee between the dividend-paying companies and the beneficiary not being regarded as sufficient to change the character of the dividends as they pass to the latter.

That being so, I think that the above conclusions are also reinforced by Armstrong v. C.I.R. 1938 A.D. 343. That decision was intensively canvassed by counsel for the parties. A full discussion of it is therefore warranted. There the beneficiary under a trust deed was entitled to £2000 per annum from the income of the trust,

which ..... /26

which in the year of assessment was comprised mostly of dividends on shares that for practical purposes can be regarded as having been vested in the trustees (p.347). Section 10(1)(k) of the then Income Tax Act, No. 40 of 1925, as amended, exempted "dividends received or accrued from any company chargeable with the normal tax imposed by this Act". This Court held that such proportion of the £2000 as came from dividends received by the trust remained dividends in the beneficiary's hands and fell within that exemption. It found it unnecessary to decide whether or not the payment was an annuity; i.e. if it was in fact an annuity that would not have affected the conclusion. As Mr. O'Donovan correctly pointed out, the reasoning of Stratford,C.J. was twofold: (a) the application of the conduit principle, and (b) the construction of the Act. As to (a), the learned Chief Justice first premised the simplest kind of case, i.e., where the trust income is derived wholly from dividends and there is only one beneficiary who under the trust deed is entitled to receive that income from the trustees. In

such ..... /27.

such a case, he said (p.349)

> "it is manifest that in the truest sense the beneficiary derives his income from the company, for that income fluctuates with the fortunes of the company and the Trustee can neither increase nor diminish it, he is a mere 'conduit pipe'".

It followed that in his view the income in such a beneficiary's hands remained "dividends received from a company" in the ordinary sense of those words. The interposition of the trustee between the company and the beneficiary did not destroy their identity and character as dividends in the beneficiary's hands (pp. 347,349); the latter was the true recipient of them.

As to (b), the learned Chief Justice said that the object of the exempting provision was to avoid the double taxation of income derived from companies and thus to exempt the true recipients of such income from the tax which had already been deducted at its source.

The conclusion from the reasoning in both (a) and (b) was that in the premised simple case the

beneficiary's .... /28

beneficiary's income still remained in his hands "dividends received from a company etc." in terms of section 10(1)(k). The judgment then proceeded to hold that the reasoning adopted in that simple case was also applicable to the more complex case under appeal. There the trust funds comprised dividends and other income out of which administrative expenses had to be paid, the trustees had to divide the trust income among several beneficiaries who were not entitled to any particular item of it, and the appellant had to receive a fixed and not proportionate amount; those were, said the learned Chief Justice, merely practical, bookkeeping, or arithmetical and not legal problems (p.351).

Mr. O'Donovan contended that the reasoning in (b) - the construction of the exempting provision - was decisive of the appeal, and that that in (a) - the conduit principle - was virtually unnecessary, although he declined to maintain that it was completely obiter. Hence, he argued, the decision was inapplicable in the present appeal since it turned on different provisions in the 1925 Act. But I do not agree. Both (a) and (b) were essential for a proper decision

of ..... /29.

of the appeal. The 1925 Act, unlike the present one , did not contain any definition of "dividends" or "shareholder". Therefore this Court had to determine, firstly, whether the words "dividends received or accrued from any company", in their ordinary sense, could include income in the beneficiary's hands derived from dividends received by the trustee from a company, and, secondly, if yes, whether that was the sense in which the words were used in the 1925 Act. In fact, it decided the former in the affirmative by applying the conduit principle and the latter mainly with reference to the object of the section, i.e., the avoidance of double taxation.

Consequently Armstrong's case in my view authoritatively established the conduit principle for general application in our system of taxation in appropriate circumstances. (It had previously been applied by a Special Court in 4 S.A.T.C. 203 at p. 209.) Mr. O'Donovan contended that, if Armstrong's case did lay down such a general principle, it was wrongly decided and should be overruled. I disagree. The principle rests upon sound and robust common sense; for, by treating the intervening trustee as a mere administrative conduit-pipe, it has regard to the substance rather than

the ..... /30.

the form of the distribution and receipt of the dividends. Moreover, the principle also seems to be recognized and applied ~~too~~ in Australia and Canada. As to the former, Syme v. C. of T. 1914 A.C. 1013, which Armstrong's case followed, was a Privy Council decision on an appeal from Victoria. But apart from that, Bock and Mannix on Australian Income Tax, 1968 Edition, Vol. 1, at p. 3122, par. 97/20 quote authorities, including Syme's and Armstrong's cases, for the principle that income retains its character in the hands of the beneficiary, a principle which apparently has in practice been accepted and acted upon by the Department ever since the inception of Commonwealth income tax - see p. 3115, par 95A/1. As to Canada, Mr. Swersky, for the respondent, made available to us certain cases of which I shall mention two: Gilhooly v. Minister of National Revenue (1945) Canadian Tax Cases 203, and M.N.R. v. Trans-Canada Investment Corporation Limited (1955)C.T.C. 275. In the first the issue

was ..... /31

was whether the appellant beneficiary was entitled to the statutory deduction for income derived from mining in respect of dividends received by the trustee from a mining company and passed on to her in terms of the trust. After referring to the authorities at length, including Syme's and Armstrong's cases, the Exchequer Court (Cameron, J.) held that she was. At p. 219 the learned Judge said:

> "Nor do I think that the mere intervention of a trustee or executor (whose duty is merely to collect mining dividends and turn over that income in the proportions and to the persons mentioned in the testators' will, as in this case) results in the ultimate beneficiary being deprived of the right of deduction for depletion."

In the second case the issue was whether dividends received by a trustee on shares registered in its name and distributed by it, after deducting its expenses, to the beneficial owners of the shares, including the respondent, were taxable as dividends in the hands of the latter with the benefit of the statutory exemption attaching thereto. The Supreme

Court of Canada, by a majority (Locke, Cartwright, and Fauteux JJ.), held that they remained dividends in the latter's hands, for the mere interposition of a trustee between the dividend-paying companies and the beneficial owner of the shares and the right of the trustee to deduct its expenses from the dividends did not change the character of the moneys in question on their passing to the beneficiary. The minority (Rand and Estey, JJ.) differed because of their interpretation of the trust agreement and the statutory provisions.

Now the 1962 Act, and especially the definitions of "dividend" and "shareholder", seem to have accepted the decisions in Armstrong's and Bell's Trust cases. That reinforces, or at least facilitates, the above construction of all the relevant provisions. Indeed, section 10(2)(b), excluding annuities from the exemption, owes its origin directly to the decision in Armstrong's case. For the legislature with good reason

must ..... /33.

must have regarded the £2000 payable annually to the beneficiary there as an annuity and, just after and (by inference) in consequence of that decision, it enacted a similar exclusion in section 10(1)(k)(iii) of the Income Tax Act, No. 31 of 1941. That exclusion was ultimately adopted in section 10(2)(b) for the purpose of the present Act.

Section 10(3) merits some attention. It reads: "The exemptions provided by any paragraph of subsection (1) shall not extend to any payments out of the revenues, receipts, accruals or profits mentioned in such paragraph". In my view the "payments out of the revenues, etc." mentioned there are those made by the true recipient of such revenues, etc. in whose hands they are exempt from normal tax by reason of section 10(1). The intention is that the exemption should not continue to attach to or follow such a payment into the hands of the payee, Hence, in regard to dividends, section 10(3) is not inconsistent with the conduit principle or the construction of the definitions of "dividend" and "shareholder" given above.

For ..... /33(a)

For the sub-section applies to payments made out of exempted dividends by the true recipient thereof, and the latter are used to ascertain who that true recipient is.

Reference was also made in argument to the provisions of the Act relating to representative taxpayers and the levying of the non-resident shareholders' tax. I find it unnecessary to deal with them; it suffices to say that they do not detract from the aforegoing views.

It follows that in my view the conduit principle operates for the purpose of section 10(1)(k)(ii) when the beneficiary of the dividends is a deemed shareholder as defined in the Act, i.e. "entitled to all or part of the benefit of the rights of participation in the profits or income attaching to the shares" registered in the trustees' name. It is that crucial phrase that can render a trustee under a trust agreement a mere conduit-pipe in

our ..... /34

present Act. Mr. O'Donovan contended, and this was his main argument, that for such a conduit-pipe to exist the beneficiary's legal entitlement under the trust deed had to vest in him not merely a personal right of action against the trustee to secure the payment of trust income, but a jus in personam ad rem acquirendam, i.e. the right to receive from the trustee the whole or part of specific dividends or dividends on specified shares. That, however, puts too narrow a construction on the above crucial phrase in the definition of "shareholder". It would virtually limit its applicability to the comparatively rare case where the beneficiary is entitled to receive from the trustee the very dividend cheque issued to him by the company. I think that its wording is manifestly wider than that. It is obviously wide enough and must have been intended to include the more usual case where the dividends vest in ownership in the trustee who is subjected to the beneficiary's mere personal right to receive his share of them, as in Bell's Trust v. C.I.R. supra (see e.g. Hiddingh v. C.I.R. 1941 A.D. 111 at p. 119; Hansen's Estate v. C.I.R. 1956(1) S.A. 398 (A) at p. 405 A-B). It is true that in some .....

cases ..... /35

cases the beneficiary's entitlement to share in dividends received by the trustee is more specific than in others. Thus in Bell's Trust v. C.I.R. the major beneficiaries were entitled to share in determinable proportions in the dividends derived from specified shares in a particular company; on the other hand in Armstrong v. C.I.R. supra, the appellant beneficiary was entitled to a fixed amount out of composite trust funds comprising dividends and other income and no beneficiary was entitled to any particular item of such funds; in the present case Mrs. Rosen has a voice in what shares the trustees shall buy and sell, and the trustees have to vote on them as she directs, but she is only entitled to certain portions of the trust's composite income. But whether the beneficiary's entitlement is more specific, as in Bell's Trust v. C.I.R., which Mr. O'Donovan relied on to illustrate his argument, or less specific as in Armstrong's and the present cases, the common factor is that the trust shares and income were vested in ownership in the trustees. The beneficiary therefore had merely a jus in

personam ..... /36.

personam against the trustees for securing the payments to him, and not a jus in personam ad rem acquirendam in any sense. Notwithstanding that, the beneficiary's legal entitlement can still fall within the wide ambit of being "entitled to all or part of the benefit of the rights of participation in the profits or income attaching to the shares" registered in the trustee's name, as was held in Bell's Trust v. C.I.R.

It is unnecessary to decide in the present appeal what limitations, if any, should be placed on the wide language of that phrase, and to what extent it applies to cases other than trust cases. It suffices to say that the trust deed may itself entitle or oblige the trustee to administer the dividends in such a way that he is not a mere conduit-pipe for passing them on to the beneficiary, that in his hands their source as dividends can no longer be identified or they otherwise lose their character and identity as dividends, and that the beneficiary is thus entitled to receive mere trust income in contradistinction

to ..... /37.

to the beneficiary's rights in terms of the above crucial phrase. Thus, a trust deed may endow the trustee with a discretion to pass on dividends to the beneficiary or to retain and accumulate them. If he decides on the latter, I think (but express no firm view) that the dividends might then lose their identity and character as dividends, so that, if they are subsequently paid out to the beneficiary, they might possibly no longer be dividends in his hands, for the conduit-pipe had turned itself off at the relevant time. But if he decides on the former, i.e. to pass the dividends on to the beneficiary, the condition suspending the beneficiary's entitlement thereto is fulfilled, and they would constitute dividends in his hands in the same way as if he had been originally entitled to them unconditionally under the trust deed, i.e. as if the conduit-pipe had always been open (cf. Voet 28.7.15, Gane Vol. 4, p.792, Estate Kemp and Others v. McDonald's Trustee 1915 A.D. 491 at p. 503, and Mount Moreland Town Lands Board v. C.I.R. 1929 A.D. 73 at p. 82/3; and Estate Munro v. C.I.R. 1925 T.P.D. 693 at p.702).

I ..... /38

I now return to the facts in the present appeal, Of the R7200 paid to Mrs. Rosen only R600 was an annuity; hence that amount is in any event excluded from the exemption from normal tax under section 10(1)(k)(ii). The R6600 was paid to her under paragraph 15(a) of the trust deed. Once the administrators and trustees exercised their discretion by deciding to pay that amount to her, the condition precedent to her becoming entitled to it was fulfilled, and she became entitled to it as if it had been originally payable to her unconditionally under the trust deed. Hence, in so far as the amount was drawn from current dividends received by the trustees during the year of assessment, i.e., non-accumulated income, her entitlement was "to all or part of the benefit of the rights of participation in the profits or income attaching to the shares" registered in the name of the trustees. She was therefore pro tanto a deemed shareholder of the companies concerned, and consequently the relevant amount remained dividends in her hands for the purpose of section 10(1)(k)(ii). That the dividends had to be administered when received by the trustees, had to be charged with administrative expenses, and ..... /39

and no fixed or proportionate amount had to be paid out of them to her, does not detract from the conclusion, for it appears that the dividends-portion of her income is still ascertainable by proper bookkeeping or arithmetic (see Armstrong's case, supra, and 4 S.A.T.C. 203 at p. 209). I have only one small reservation. The balance of trust income of R792 brought forward from the previous year possibly represents partly or wholly accumulated dividends. To the extent that the R6600 was drawn from that amount it might not constitute dividends in her hands in the year of assessment. I express no final view on that since it was not argued. No doubt it will be considered and dealt with in the Secretary's re-assessment. Subject to that, I think that the conclusion of the Special Court on the first issue was correct.

Finally, the third issue - whether the deduction ~~in~~ section 19(3) applied to Mrs. Rosen's annuity of R600. For easy reference here I repeat that the deduction is permissible "in respect of income in the form of dividends derived by any person". It is safe to infer that on a

proportionate .... /40

proportionate basis most or at least a substantial part of the amount of R600 was drawn from dividends. Again, "dividends" in that section must be given its defined meaning; the contrary was not contended. Hence, for reasons already stated, the dividends-portion of the annuity would also constitute "dividends derived" by Mrs. Rosen, unless the proper interpretation of section 19(3) precludes that conclusion. It was argued that she derived her income "in the form of an annuity" and not "in the form of dividends". The fallacy in that contention is that it presupposes that the two forms are mutually exclusive, which they are not. According to the definition of "gross income" both an annuity and dividends are items of income subject to normal tax (section 1(a) and (k)). From the earlier discussion in this judgment it is clear that the same item of income may constitute both an annuity and dividends. As an illustration, take the simple form of trust in which its income consists wholly of dividends out of which the trustee is obliged by the trust deed to pay a fixed amount annually to the sole beneficiary. According to this judgment the form of that income in the

latter's hands would clearly be an annuity and also dividends. The decision in Armstrong v. C.I.R., supra, also supports that conclusion. For it decided that the fixed annual payment of £2000 to the beneficiary constituted dividends pro tanto, irrespective of whether or not it was also an annuity. Now the legislature intended in section 19(3) that the taxpayer deriving income in the form of dividends should have the benefit of the deduction therein specified. It could not have intended that he should be deprived of that benefit merely because those dividends also happen to be an annuity; otherwise it would have expressly enacted, as it did in section 10(2)(b) in relation to the exemption of the dividends in section 10(1)(k)(ii), that annuities should be excluded from that deduction.

In my view therefore the conclusion of the Special Court on this issue was also correct.

The appeal is dismissed with costs, including the costs relating to two counsel.

W.G.TROLLIP, J.A.

Ogilvie Thompson, J.A.)
Holmes, J.A.)
Jansen, J.A.) concur.
Muller, A.J.A.)