45/88

IN THE SUPREME COURT OF SOUTH AFRICA

(APPELLATE DIVISION)

In the matter between:

NELSON RAYMOND TUCK .. Appellant

and

COMMISSIONER FOR INLAND REVENUE..... Respondent

CORAM: CORBETT, VAN HEERDEN, SMALBERGER, VIVIER, JJA, et BOSHOFF AJA.

DATE OF HEARING: 4 May 1988

DATE OF JUDGMENT: 16 May 1988

JUDGMENT

CORBETT JA:

During the year of assessment ended 28 February 1982 the appellant, Mr N R Tuck, received 826 shares in American Home Products Corporation, of New York ("American Home"), in terms of what was called a "Management Incentive

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Plan". The value of the shares at the date of receipt, in March 1981, was R20 977. In assessing appellant to income tax for the 1982 tax year respondent, the Commissioner for Inland Revenue, included this amount of R20 977 in appellant's taxable income. Appellant objected to this inclusion and, his objection having been disallowed, appealed to the Transvaal Income Tax Special Court.

The Special Court (presided over by Melamet J), having heard evidence and argument, held that the amount of R20 977 constituted a receipt of a capital nature and that it was, therefore, not taxable. The Court accordingly allowed the appeal, set aside the assessment and referred the matter back to the respondent for re-assessment. Respondent appealed to the Transvaal Provincial Division ("TPD"), which allowed the appeal with costs and substituted an order dismissing the appeal and confirming the assessment. With leave of the TPD appellant now appeals

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to this Court and seeks the restoration of the order of the Special Court.

The essential facts are not in dispute and may be summarized as follows. In 1949 appellant, a registered pharmacist, entered the employ of a company called Wyeth Laboratories (Pty) Ltd ("Wyeth") as sales manager. In 1951 he was appointed managing director and general manager of the company and he continued in that position until his retirement in September 1979 at the age of 65 years.

Wyeth was incorporated in South Africa in 1947 as a wholly-owned subsidiary of American Home. It manufactures certain pharmaceutical products and nutritional foods and markets these products in South Africa. In its first year of operation after appellant had joined the company Wyeth registered sales to the value of about £100 000 and a pre-tax profit of £12. Under appellant's

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management, however, the company prospered and by 1979 its sales had risen to R13 311 000 and its pre-tax profit to R3 362 000.

Appellant played a prominent role in the pharmaceutical industry. He served upon a number of pharmaceutical commissions and committees. Mr Trollip, an attorney with considerable experience of the pharmaceutical industry, who gave evidence before the Special Court, stated that, of all the people he met in the industry, he regarded appellant "as probably the outstanding personality". Appellant's particular strengths were his knowledge and experience in the marketing sphere and the very good relationships that he had been able to build up over the years with the various public authorities concerned with the pharmaceutical industry.

In 1967 American Home introduced the aforementioned Management Incentive Plan ("the Plan") for its employees and the employees of its subsidiaries in different parts

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of the world. The Plan is set forth in a printed document, which was attached to the letter of objection and marked "1A" and which forms part of the case dossier. I shall refer to this document as "Annexure 1A". Annexure 1A, which is headed as follows —

"American Home Products Corporation
Management Incentive Plan"

is divided into eight paragraphs. Paragraph I, headed "Purpose", reads as follows:

> "The Management Incentive Plan ('the Plan') is designed to provide for awards to selected salaried employees in executive, administrative, technical, professional or other important capacities, who individually, or as members of a group, contribute in a substantial degree to the success of the Company, thus affording to them a means of participating in that success and an incentive to contribute further to that success".

As appears from the remainder of Annexure 1A, the Plan is administered by a committee (para. III), which each year determines the individual employees eligible to receive

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awards under the Plan and the awards to be made from a fund known as the Award Fund (para. IV). In each year the Award Fund is determined by the board of directors of American Home, on the recommendation of the committee, in accordance with a formula, which is related to the financial success of the company's business operations. There are three types of award: (i) a cash award, (ii) a contingent cash award and (iii) a contingent stock award (paras. II and V). In this case only the third of these, the contingent stock award, is of relevance.

A contingent stock award is made from a large block of unissued American Home shares kept for this purpose, known as the Corporation's Common Stock (para. V). Where a contingent stock award is made the amount of the award is converted into a certain number of shares, regard being had to the market price of such shares on the New York Stock Exchange at the end of the calendar year for which the

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award is made. At that stage, however, no shares are delivered to the employee concerned; American Home merely credits a contingent award account in his name with the award of the number of shares so determined. Moreover, pending delivery, no particular shares are earmarked for the account of the employee, nor does he have the rights of a stockholder in respect thereof. Nevertheless, the company annually determines the dividends which would have been paid on the shares credited to each contingent award account and the account is further credited with shares equivalent to the total amount of the dividend (para. VI(3)).

Leaving aside the case of an employee who dies or is discharged from the employ of the company or whose employment is terminated for some other reason prior to retirement (for which eventualities the Plan makes special provision — see para VI(4)(a), (b) and (c)), the shares standing to the credit of an employee's contingent award

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account at the time of his retirement are delivered to him after his retirement in ten (approximately) equal annual instalments. Such delivery is, however, made subject to the ex-employee having, up to the date of delivery, complied with certain conditions. This is provided for in para. VI(4)(d) of the Plan, the relevant portion of which reads as follows:

> "(d) No .... delivery from a Contingent Award Account shall be made to any Employee after termination of employment unless he shall have to the date fixed for such payment or delivery (i) refrained from becoming or serving as an officer, director or employee of any individual, partnership or corporation, or the owner of a business, or a member of a partnership which conducts a business in competition with the Company or renders a service (including, without limitation, advertising agencies and business consultants) to competitors with any portion of the business of the Company, (ii) made himself available, if so requested by the Company, at reasonable times and upon a reasonable basis to consult with, supply information to, and otherwise cooperate with, the Company and (iii) refrained from engaging

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> in deliberate action which, as determined by the Committee, causes substantial harm to the interests of the Company. If these conditions are not fulfilled, no further .... delivery shall thereafter be made with respect to the Employee's Contingent........Stock Awards and all his rights with respect to his Contingent Award Account shall thereupon be forfeited."

In order to ascertain whether there has been compliance with these conditions, former employees to whom shares have been awarded under the Plan are required each year to complete a questionnaire giving details of any "business entity" with which the former employee may have become associated since his retirement. And it is only after receiving and considering the completed questionnaire that the committee determines the eligibility of the ex-employee to receive his annual instalment of shares.

In terms of this Plan shares in American Home were over the years of his employment awarded to appellant and

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credited to a contingent award account in his name. At the time of his retirement his account stood at 7675 shares. In his first year of retirement, during April 1980, he received delivery of 668 shares as an initial annual instalment. When submitting his income tax return for the 1981 tax year, appellant enclosed a letter, in which he explained the origin of the 668 shares and stated that at current stock exchange prices and rates of exchange as between US dollar and the rand the total value of the shares as at the date of delivery was R14 251. The letter went on to submit that the shares were received partly as remuneration for services rendered and partly as payment for being restrained from competing with the company or doing anything causing harm to the company; and that half of the amount received was in respect of services rendered and half in respect of the restraint, and that the latter receipt was one of a capital nature. The letter concluded by contending that accordingly only

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half the amount received, viz R7 125, was taxable. This was the amount reflected as taxable income in appellant's return in respect of the receipt of the 668 shares. Appellant appears to have been assessed at that stage upon this basis for the 1981 tax year.

In the following year the appellant received a further instalment of 826 shares to the value (at the time of delivery) of R20 977 and again in his return of income for the 1982 tax year appellant reflected half this amount, viz R10 488, as income for the year. A letter accompanied his return in which he referred to the earlier letter submitted with his 1981 return and repeated the submissions in the 1981 letter as to why only half the value of the shares was shown as income.

On this occasion, as I have indicated, the respondent did not accept this apportionment of the receipt relating to the shares, but included the full value of

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the shares in his assessment of appellant's taxable income. Furthermore he raised an additional assessment in respect of the 1981 tax year. In the letter of objection written on appellant's behalf by his attorneys in regard to the 1982 assessment the following was stated:

> "We point out that our client claimed only 50% of the value of the shares to be in respect of a restraint and the balance was submitted to be remuneration for services rendered and therefore taxable. In doing this, our client was motivated with the idea of being reasonable to the Inland Revenue Directorate. We submit, however, that on principle, since the essential and dominating nature of the transaction was the restraint, no part of the award was of a revenue nature or taxable.
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> In the alternative, it is submitted that the award to our client was partly in respect of services rendered and partly in respect of a restraint and that an apportionment is competent. A fair and reasonable apportionment would require that more than 50% of the value of the receipt would be of a capital nature, but we have had some difficulty in finding a formula to quantify the amount. Accordingly, we suggest that, as originally returned by our client, a fair and reasonable apportionment would be on a 50/50 basis."

Succinctly put, the judgment of the Special Court was to the effect that the dominant reason for the delivery of the shares to the appellant in the year under consideration was appellant's compliance with the first of the conditions stated in para VI(4)(d), which was described by Melamet J as "the restraint undertaking". The payment was consequently for the sterilization, in part or in whole, of an asset of appellant's, viz the right to trade freely, and was thus a payment of a capital nature and not taxable.

The judgment of the Court a quo has been reported (see Commissioner for Inland Revenue v Tuck 1987 (2) SA 219 (T)). In terms thereof the TPD held that, on the contrary, the dominant purpose of the Plan was to reward excellence in management and to spur on employees to continue to render such service (see pp 223 J - 224 A); and furthermore that since the Plan did not indicate that allottees of shares were given their shares as a *quid pro quo* for restricting their freedom to compete (at most it indicated a free choice to compete with the risk of a forfeiture of shares), the principles relating to the sterilization of an asset did not apply and the receipt was consequently not of a capital nature (see p 224 C-H).

On appeal to this Court appellant's counsel, Mr *Welsh*, advanced two main contentions: (i) that the causally relevant factor which resulted in the receipt by appellant of the shares in issue was appellant's compliance with the restraint of trade provided for in para VI(4)(d) of Annexure 1A and that consequently the receipt was wholly of a capital nature; and (ii) that, alternatively, the receipt of the shares was attributable at least in part to appellant's compliance with the restraint and that there should accordingly be an apportionment of the receipt as between income and a capital receipt.

In support of the first of these contentions, Mr _Welsh_ referred to the dictum of Watermeyer CJ in the case of _Commissioner for Inland Revenue v Lever Bros. and Another_ 1946 AD 441, at p 450, with reference to the source of income, viz —

> ".......that the source of receipts, received as income, is not the quarter whence they come, but the originating cause of their being received as income, and that this originating cause is the work which the taxpayer does to earn them, the _quid pro quo_ which he gives in return for which he receives them. The work which he does may be a business which he carries on, or an enterprise which he undertakes, or an activity in which he engages and it may take the form of personal exertion, mental or physical, or it may take the form of employment of capital either by using it to earn income or by letting its use to someone else. Often the work is some combination of these".

On the basis of this dictum Mr _Welsh_ argued that, though the making of the original awards was a _conditio sine qua non_ of the receipt of the shares by the appellant, the real causally relevant factor was appellant's compliance with the restraint condition; and that consequently the whole of the receipt was of a capital nature. In this connection he referred to a statement by Mr Justice Schreiner sitting as President of the Swaziland Court of Appeal in the case of Mathenjwa v R (1970 - 1976) Swaziland Law Reports 25, at p 29. Having referred to a decision of the Rhodesian Court of Appeal, Schreiner P stated:

> "I am in respectful agreement with the view expressed ....that *causa sine qua non*, or what has been called 'but for' cause, is not a cause in the law of culpable homicide. Indeed generally in law you seek the fact that actually produces the result or positively contributes to its production and not a fact that only provides the occasion or opportunity for the result to be produced".

Mr Welsh also relied upon certain other authorities, particularly the judgment of this Court in Commissioner for Inland Revenue v Shell Southern Africa Pension Fund

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1984 (1) SA 672 (A), where the issue was whether a lump sum payment from a pension fund to the widow of a deceased member (where such payment was in the discretion of the committee administering the fund) 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" in sec 1 of the Income Tax Act 58 of 1962. This Court (per Nicholas JA) held that the problem was one of causation, viz whether, in a case where a lump sum becomes recoverable as a result of the exercise of the committee of its discretion, there is the required causal connection between the recoverability and the death of the member. In the course of his judgment Nicholas JA stated (at p 679 B-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

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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 Honoré 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 fine, the latest event in a train of physical events is not necessarily 'caused by' the first event. The learned Judge said at 254 that

> 'the test of causation is to be found by recognizing 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 committe 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

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> it isolates the original cause A so as to relegate it 'to the status of a merely historical antecedent or background feature' ".

It was held that the decision of the committee did constitute the intervention of "an independent, unconnected and extraneous causative factor or event" (p 679 H) which isolated the death of the member from the final result; and that, therefore, the lump sum did not become recoverable in consequence of or following upon the death of the member.

The question of causation, especially in the field of delict, has been considered by this Court in a number of recent cases (see eg Da Silva and Another v Coutinho 1971 (3) SA 123 (A), at pp 147 D - 148 E; Minister of Police v Skosana 1977 (1) SA 31 (A), at pp 33 A-B, 34 F - 35 D, 43 E - 44 F; Standard Bank of South Africa Ltd v Coetsee 1981 (1) SA 1131 (A), at pp 1138 G - 1139 C; S v Daniëls en 'n Ander 1983 (3) SA 275 (A), at pp 324 F-

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325 E, 331 B - 333 G; and Siman & Co (Pty) Ltd v Barclays National Bank Ltd 1984 (2) SA 888 (A), at pp 914 F - 915 B). I do not propose to canvass fully the discussion of this question in these judgments. Suffice it to say that it is generally recognized 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 recognized 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 8 LAWSA paras 47-9.) The Shell case, supra, was an instance of such a novus actus interveniens.

It follows from this that a conditio sine qua non may in fact be a legally relevant cause provided that it passes the test of constituting causation in law, but generally speaking a fact which is not a conditio sine

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qua non cannot constitute a cause in law (there may be exceptions - see Skosana's case, supra, at p 35 C-D).

I am not sure that it is appropriate to apply the principles of causation, as developed particularly in the criminal law and the delictual field, when considering the problem as to how, from the income tax point of view, a taxpayer's receipt should be characterized, ie whether as income or as capital. In the Shell case, supra, the Court was directed to these principles of causation by the particular wording of para (e) of the definition of "gross income". In a case such as the present, however, it seems to me that most problems of characterization could appropriately be dealt with by applying the simple test indicated by Watermeyer CJ in the passage quoted from his judgment in the Lever Bros case, supra, viz. by asking what work, if any, did the taxpayer do in order to earn the receipt in question,

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what was the quid pro quo which he gave for the receipt?

The quid pro quo given by appellant in this case is to be found in the Plan. In my opinion, it has two main elements. Firstly, there is the element of service given to the company, Wyeth, over the years, which so contributed to the business success of American Home as to earn appellant annual awards of shares which were credited to his contingent award account in terms of the Plan. It is conceded by Mr Welsh that this element is of a revenue nature. Secondly, there is the element of restraint of trade, flowing from condition (i) in para VI(4)(d) of the Plan, compliance with which is a pre-requisite to appellant receiving his annual instalments of shares over a ten-year period. There are, of course, two other conditions in para VI(4)(d), but on the evidence condition (i) appears to have been the most important one. It is conceded by Mr Marais, who appeared on behalf of the respondent, that the restraint of trade element is of a capital nature.

It seems to me that it would be totally unrealistic to say that in this case the _quid pro quo_ given by the appellant for the receipt of the shares was solely his compliance with condition (i) of para VI(4)(d). It is true that had he failed to comply with condition (i) appellant would have received nothing. But equally had he not given service of a particular quality over the years he would have received nothing. And we are, of course, _ex hypothesi_ concerned with the situation where there has been compliance; otherwise there would have been no receipt to characterize. The mere fact that the one element, viz the service, occurred chronologically before the other, viz the compliance with the condition, cannot, in my view, alter the basic conclusion that the _quid pro quo_ given by appellant for the receipt of his shares comprised both elements, viz service and compliance with the restraint.

In my opinion, it would be equally unrealistic to say that the quid pro quo given by appellant was solely his excellent service during the years of his employment. This was initially the contention put forward on behalf of the Commissioner, but in oral argument before us Mr Marais did not appear to press the point with any enthusiasm.

Reverting to Mr Welsh's argument, I am of the view that even if one applies the principles of legal causation referred to above, one reaches the same conclusion. Appellant's excellent service was obviously a conditio sine qua non of the ultimate receipt of the shares and thus qualifies as a cause in fact. Appellant's compliance with condition (i) was obviously a contributory cause in fact, but in my view it did not introduce an independent, unconnected and extraneous causative factor of such significance as to relegate the excellent service to the status of a mere historical antecedent or background feature. The service and the restraint condition were part and parcel of the same scheme and it rested with appellant as to whether the restraint condition was complied with or not. Both were, in my opinion, causally relevant factors. Appellant's main argument cannot, therefore, succeed.

I turn now to the alternative argument. In this regard Mr Welsh pointed out, with reference to certain decided cases, that, despite the absence of statutory authorization, this Court had in the past approved of the principle of apportionment in dealing with the deductibility of expenditure which was partly of a capital nature and partly not (see Secretary for Inland Revenue v Guardian Assurance Holdings (SA) Ltd 1976 (4) SA 522 (A), at pp 533 E - 534 A; Borstlap v Sekretaris van Binnelandse

Inkomste 1981 (4) SA 836 (A), at p 849 E-G; and Commissioner for Inland Revenue v Nemojim (Pty) Ltd 1983 (4) SA 935 (A), at p 951 B-D); and also with regard to deemed income under sec 7(3) of the Income Tax Act, where there were elements of both gratuitousness and consideration (Ovenstone v Secretary for Inland Revenue 1980 (2) SA 721 (A), at p 740 B-F). 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 pro quo contains two or more separate elements, one or more of which would characterize 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 (see Tilley v Wales (Inspector of Taxes) 1943 AC 386, at p 393/4, 398; Carter v Wadman (H.M. Inspector of Taxes) (1946) 28 TC 41, at pp 52/3) and in Australia (see McLaurin v Federal Commissioner of Taxation (1961) 8 AITR 180, at p 191).

The problem in this case is to establish an acceptable basis of apportionment. The appellant has

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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 (cf. Commissioner for Inland Revenue v Rand Selections Corporation Ltd 1956 (3) SA 124 (A), at p 131; the Nemojim case, supra, at p 958), but I do not think that this should constitute an insuperable obstacle. Mr Marais submitted in argument that appellant had failed to adduce all relevant evidence in this regard and suggested, by way of example, that a highly-placed executive in American Home could have told the Special Court how the company regarded the relative importance of the service and restraint elements. I do not think that this submission is sound. The Plan and the actions of the company speak for themselves and I doubt whether the evidence of such an executive, if admissible, could have added anything of substance.

It is obvious from the Plan that both elements are important factors in the *quid pro quo* which the employee provides in return for receiving the shares. If the employee does not provide the requisite service, he does not qualify for an award; if he fails to comply with the restraint, he forfeits the award. The importance attached by the company to the service appears from para I of Annexure 1A which indicates that the very purpose of the Plan is to reward service which has contributed to the success of the company and to provide an incentive for such service in the future. At the same time how seriously the company regards the restraint condition is illustrated by the evidence of Kernick, who forfeited all right to the shares credited to his contingent award account when he left the service of Wyeth to join a South African company which produced a commodity, which was not manufactured by Wyeth, but was manufactured by other over-

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seas companies in the group, and who did not have his rights to this contingent award account reinstated when he rejoined the American Home group some three years later; and by the fact that each year a potential recipient of shares has to first complete and remit to the company a questionnaire, designed to check whether he has complied with the restraint or not, before he receives his shares. The duration of the restraint is also an indication of the importance attached to this element by the company. 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.

It follows that the appeal should be allowed and the matter remitted to the respondent for reassessment in the light of this judgment. The success of the appeal naturally carries with it the costs of appeal. There

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are no costs to be considered as far as the hearing before the Special Court is concerned. As to the costs in the Court a quo, Mr Marais very fairly conceded that appellant should be awarded these costs. This concession was, in my view, correctly made. As I have shown, the appellant submitted his original return on the basis of a 50/50 apportionment of the receipt in issue; and when objecting to the respondent's assessment he put forward such an apportionment as an alternative contention. Had the respondent not insisted upon the viewpoint that the whole receipt was taxable, I have no doubt that no litigation would have ensued. It is true that the Special Court judgment gave the appellant more than he was entitled to, but in his notice of appeal respondent made no mention of an apportionment: his attitude was still that the whole receipt was taxable. Had he at that stage conceded that he was only entitled to a 50/50 apportionment

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it seems probable that appellant would not have contested the appeal. The appellant would after all have got what he had asked for all along. It, therefore, seems appropriate that respondent should bear the costs of the appeal to the Court *a quo*.

The appeal is allowed with costs and there is substituted for the orders made by the Special Court and the Court *a quo* the following order:

> "The appeal is allowed and the matter is remitted to the Commissioner for re-assessment upon the basis that only 50% of the receipt in respect of the American Home shares constituted taxable income in the hands of the appellant."

The respondent is to pay the costs of the appeal to the Court *a quo*.

M M CORBETT

VAN HEERDEN JA)
SMALBERGER JA)
VIVIER JA) CONCUR.
BOSHOFF AJA)