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Case No 125/1989

IN THE SUPREME COURT OF SOUTH AFRICA

(APPELLATE DIVISION)

In the matter between:

SOLAGLASS FINANCE COMPANY (PTY) LIMITED Appellant

and

COMMISSIONER FOR INLAND REVENUE Respondent

CORAM: BOTHA, E M GROSSKOPF JJA, NICHOLAS, FRIEDMAN *et* NIENABER AJJA

HEARD: 13 SEPTEMBER 1990

DELIVERED: 30 NOVEMBER 1990

JUDGMENT

BOTHA JA:-

I have had the benefit of reading the judgment of my Brother FRIEDMAN. In his judgment it is held (a) that the capital which the appellant lost as a result of being unable to recover the loans in question was not fixed, but circulating capital, and therefore of a revenue nature, and that the losses in question were accordingly deductible in terms of section 11(a); and (b) that the losses were not disqualified from deduction by reason of the provisions of section 23(g). I agree with (a), but I respectfully differ on (b). In my judgment section 23(g) precludes the deductions claimed by the appellant, and the appeal should fail on that ground. My reasons for this view follow.

Section 23(g) does not refer in terms to "losses", as does section 11(a). Counsel for the appellant based an argument on the difference, in this respect, between the two sections. He said that it showed that the Legislature did not intend section 23(g) to apply to the deduction of "losses" at all;

and, since the appellant was clearly claiming a deduction of "losses", and nothing else, its claim could not be barred by section 23(g). I do not agree. It seems to me that the argument does violence to the plain meaning and effect of the language used in section 23(g), particularly when it is contrasted with the wording of section 11(a), and more especially when it is considered in the context of the other paragraphs of section 23, as I shall now endeavour to show.

Section 23(g) reads:

> "23. No deductions shall in any case be made *in respect of the following matters*, namely -
>
> ....
>
> (g) any moneys claimed as a deduction from income derived from trade, which are not wholly or exclusively laid out or expended for the purposes of trade; ....."

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

(i) deductions

(ii) in respect of

(iii) any moneys

(iv) claimed as a deduction from income derived from trade

(v) which are not wholly or exclusively laid out or expended for the purposes of trade.

The core of the prohibition is to be found in (iii): "any moneys". That expression in itself is not concerned with "losses", either inclusively or exclusively; it is entirely neutral in relation to the concept of "losses". So is the wording of (v), which is the substance of the prohibition. Re-casting it in positive terms, the requirement is that any moneys sought to be deducted must be moneys which are laid out or expended in the manner specified. The requirement comprises two component notions: (a) moneys which are laid out or expended; and (b) in a particular manner, i e wholly and exclusively for the purposes of trade.

But the requirement in no way touches upon the question whether moneys which are laid out or expended have been lost or not. That is immaterial for the purposes of the section, according to its wording. Moneys which are laid out or expended are decreed not to be deductible if they are not laid out or expended in the manner required. There is nothing in the section to support the argument that the prohibition does not apply when moneys which are laid out or expended happen to result in losses.

I turn to section 11(a). In so far as it is relevant for present purposes, its ingredients may be stated as follows:

(i) there shall be allowed as deductions from the income

(ii) expenditure and losses

(iii) actually incurred

(iv) in the production of the income

(v) provided such expenditure and losses are not of a capital nature.

The pivot of the provision lies in (ii): ""expenditure and losses". This expression characterizes the nature of that which is authorized to be deducted. Consequently, in applying the section, it may be necessary to consider the distinction between "expenditure" and "losses" and the contrasting concepts of voluntary payments and involuntary deprivations (cf Joffe & Co Ltd v Commissioner for Inland Revenue 1946 AD 157 at 166-7), and such consideration may be important when it comes to applying the proviso in (v), where the issue is whether or not the expenditure, or the losses, are of a capital nature (see Stone v Secretary for Inland Revenue 1974 (3) SA 584 (A) at 593E-594H, and Burman v Commissioner for Inland Revenue, AD judgment delivered on 23 November 1990). So, in the case of a loan which has become irrecoverable, the amount of which is sought to be deducted, important considerations are that it is not the "expenditure" incurred in advancing the loan which is sought to be deducted, but the loss of the loan capital by reason of its having become irrecoverable; and in that regard, for the purposes of applying the section, it is relevant to observe that were it not for the loss of the loan capital there would be no question of any deduction and that the real issue in such a case is the deductibility of the loss (see Stone's case supra at 593E-F). But in my view considerations such as these are confined to the context of section 11(a); they have no bearing on the application of section 23(g). Section 11(a) provides positively for what may be deducted, and section 23(g) negatively for what may not, but there is no direct correlation between the one and the other. So, for instance, the question whether or not expenditure is of a capital nature is vital to the enquiry under section 11(a), but it plays no role in the application of section 23(g). The enquiries under the two sections are notionally and logically discrete. That this is so is demonstrated by the fact that the Legislature did not transpose the descriptive expression "expenditure and losses" from section 11(a) to section 23(g); instead, it used in the latter section the colourless expression "any moneys". Section 11(a) is concerned with the deduction of "expenditure" qua expenditure and the deduction of "losses" qua losses, while section 23(g) focusses on the deduction of "moneys" qua moneys. And "moneys ..... laid out or expended" do not become the less so because they are lost.

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

"(a) the cost incurred .....

(b) domestic or private expenses .....

(c) any loss or expense, the deduction of which would otherwise be allowable .....

(d) the taxation levied .....

(e) income .....

(f) any expenses incurred .....

(g) any moneys claimed as a deduction .....

(h) interest .....

(i) entertainment expenditure ....."

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

Applying the views expressed above to the facts of this case, I see the position as follows. The appellant, in taking over or advancing the loans in question, laid out and expended moneys; it incurred expenditure. When the loans became irrecoverable, it incurred losses. The deductions to which the appellant lays claim represent, at one and the same time, the moneys laid out and expended, the expenditure incurred, and the losses incurred. In order to determine whether the deductions claimed are allowable under section 11(a), an assessment of the nature of the losses incurred is called for. That enquiry yields the answer that the losses are deductible under section 11(a). We then move on to a different enquiry: whether the losses, found to be deductible under section 11(a), are disqualified from deduction by virtue of section 23(g). For the purposes of this enquiry, the nature of the losses, qua losses, is no longer of any consequence. What is important, viewed through the framework of section 23(g), is the characteristic of the losses as constituting, as a matter of fact, "moneys claimed as a deduction from income derived from trade". There is no doubt that the losses fall squarely within the ambit of these words. Nor can there be any doubt that the "losses", in their new garb of "moneys claimed as a deduction", were, again as a matter of fact, "laid out or expended" by the appellant. In consequence, for the deductions claimed by the appellant to pass the test of section 23(g), it must be shown that the amounts of the loans made by the appellant were wholly and exclusively laid out or expended for the purposes of trade.

I proceed, then, to consider whether that has been established. I commence with some general observations. The word "wholly" has no role to play in this case, and may be left out of account. In so far as there may be different nuances to the expressions "laid out" and "expended", I do not see that they can be of any relevance to the facts of this case; they can also be left out of consideration. The word "trade", in the expression "for the purposes of trade", is not expressly qualified, but it must be taken to be confined to the actual trade being carried on by the taxpayer. That is no doubt an obviously necessary implication, but, in view of the particular facts of this case, it needs to be pointed out that a purpose connected with a trade being carried on by a person other than the taxpayer may serve to disqualify a deduction, if the link between the purpose and such other business is sufficiently close to be caught in the net of the section. The meaning of the words "exclusively laid out or expended for the purposes of trade", and of similar words in other statutes, has been considered in a number of cases, some of which are discussed in the judgment of my Brother FRIEDMAN (and to which may be added a recent case decided in the House of Lords, to which we were referred in argument, MacKinlay (Inspector of Taxes) v Arthur Young McClelland Moores & Co [1990] 1 All ER 45). However, in none of the cases referred to in argument did the facts resemble, even remotely, the peculiar facts of the present matter. To the extent that the reported judgments reflect the use of general criteria in applying the words of the statute concerned to the facts of a particular case, such criteria appear to me to furnish no more than vague and imprecise guidelines, fitting nicely perhaps the facts under consideration, but to be applied to other and different factual situations, if at all, only with caution and circumspection. So, for instance, the distinction between "motive" and "purpose" in this context seems to me to be a nebulous one: it may sometimes be found to be helpful, but at other times it may be conducive more to confusion than to clarity. Again, the distinction between "object" and "effect" seems to me to be incapable of exact definition, and hence of little real use as a general test. And the same applies to the suggested distinction, urged upon us by counsel for the appellant, between "subjective intention" and "objective purpose". The truth is, in my judgment, that there are no hard and fast rules for deciding whether a taxpaper's expenditure falls within or outside the ambit of the section; it is not possible to devise any precise universal test for determining whether expenditure comprises moneys "exclusively laid out or expended for the purposes of trade". In general, one can say no more than that the issue is to be resolved by examining the particular facts of each individual case.

I turn, then, to the facts. They have been summarized in the judgment of my Brother FRIEDMAN, which contains also some excerpts from the evidence of Mr Scott. In my view that evidence provides a clear and cogent answer to the present enquiry. I find it necessary, therefore, to quote again the relevant passages from the evidence, grouping them together, and making some minor additions, to let the story flow more easily. The extracts which follow are all taken from the witness's evidence when he was being examined in chief by the appellant's counsel.

> "In your capacity as Finance Director of the group, were you involved with the affairs of the Appellant company? -- The affairs of the Appellant company were by and large my responsibility.
>
> When you joined the group, the Appellant company was already in existence? -- That is correct.
>
> Are you aware of the reason for it

coming into existence? -- Yes, I am.

Would you just explain that to the Court? -- My lord, it had been determined prior to my arrival at Plate Glass, that the financial affairs of the group would most effectively [be] conducted by the formation of a finance company through which the securing and arrangements of funds for the group could be best done and through which the use of those funds, by subsidiary companies, could be best monitored."

"Now did the Appellant company make a profit on these Bills, or was it aiming to make a profit on these Bills? -- Yes, my lord, it was.

Did the Appellant company aim to make a profit on the borrowing and lending of its funds? -- Yes, my lord.

What was the Appellant company's philosophy with regard to its dealings with its fellow subsidiary companies?-- The philosophy, my lord, of the Finance Company was at all times to be supportive and back the aims of the group trading companies. That was one of the main philosophies guiding the Finance Company. In the structuring and design of the method whereby it performed this function it sought at all times to make a profit by the process of securing funds at a lesser average rate than the rate at which it lent funds to its fellow subsidiaries in respect of the acquisition of Bills Receivable, and even in fact, in the majority of instances to the lending of money to members of staff.

We've seen that there was some

R34 000 000 odd owing to the holding company and fellow subsidiaries. What happened when one of the fellow subsidiaries had surplus funds? -- Surplus funds. The process, my lord, whereby the affairs of the Finance Company and in fact, the finances of the group were managed were such, that surplus funds were required to be placed with the Finance Company on a daily basis.

What happened when some other subsidiary was short of funds? -- Then it was the responsibility, my lord, of the Finance Company to make available those funds to the subsidiary for the purposes of its operations."

"The interest rates did vary from company to company, did they? -- Yes, they did from company to company, my lord.

Would you explain to the Court why there was this variation? -- In terms of its basic lending and operational philosophy, my lord, the lending was conducted for two reasons firstly, to ensure there was a profit overall on average cost of money to average cost of lending money, but at the same time the interest of the borrowing company as a member of the group of companies was borne in mind and there were occasions when loans at lower rates of interest were made to companies that were not performing perhaps as well as others."

"Would you agree with a suggestion that the Appellant company was not an independent company operating an independent business? -- I would accept, my lord, that it was not totally independent.

What were your aims in that regard? -- The aims, my lord, of this company were several, but the principal objective was by means of consolidating third party debt to secure the most advantageous terms and conditions for borrowings whilst at the same time organizing and ensuring the availability of finance for the group's subsidiaries. But within the structure of those motives the company was designed to secure profit for itself."

In my opinion the evidence speaks for itself, and in so speaking it proclaims that the appellant's trading activities were geared to the achievement of a dual purpose: furthering the interests of the Group's subsidiaries and thus of the Group itself; and making a profit for the appellant.

Counsel for the appellant argued to the contrary, on a number of grounds. I proceed to deal with the main points raised in argument. To begin with, it was suggested that, although the appellant company may have been brought into operation for the purpose of promoting the interests of the Group, when once it commenced, and thereafter continued, its trading activities, it did so for the sole purpose of serving its own interests by earning a profit, and not with a purpose of advancing the Group interests. I see no merit in the suggested dichotomy between the creation of the trading concern and its actual activities. What was aimed at by the former was achieved by the latter. The object of promoting the Group interests, which gave birth to the appellant as a trading entity, did not disappear with the actual carrying on of the business, but was in fact implemented thereby. The appellant was itself a wholly owned subsidiary within the Group. The controlling mind which brought it into operation also directed its ongoing activities. And the evidence shows that such activities were in fact directed, not only at earning a profit for the appellant, but also at promoting the interests of the Group.

Then it was argued that the promotion of the

Group interests was merely a motive of the appellant in carrying on its trade, and not a purpose of it. I am unable to perceive any room for applying the distinction between the two concepts to the facts of this case, whatever the line of demarcation between them may be. The present is not the kind of case which is epitomized by the example of a trader who elects to buy his stock-in-trade from a relative or friend, in order to benefit the latter (cf Commissioner of Taxes v B S A Co Investments Ltd 1966 (1) SA 530 (SR AD), a case heavily relied on by the appellant's counsel). In that kind of case the benefit conferred on another person is but indirectly and remotely connected with the trading activities of the taxpayer. Here the position is quite different. On the evidence, the promotion of the Group interests is an integral part of the very activities carried on by the appellant. It borrows money from subsidiaries in the Group whenever they have a surplus available, irrespective of the needs of the appellant at that time. It lends money to subsidiaries at a reduced rate of interest whenever the interests of the subsidiaries concerned require that to be done, irrespective of the attendant disadvantage to the appellant. In short, the trading activities of the appellant are governed by policy considerations dictated by the interests of the Group. To talk of "motive" as opposed to "purpose" in relation to the appellant's furthering of Group interests is to ignore the evidence.

Two further lines of argument advanced on behalf of the appellant fall to be rejected for reasons similar to those stated above. The first was that the promotion of the Group interests was merely the appellant's "subjective intention" and not the "objective purpose" of its trading activities. The second was that the promotion of the Group interests was not a "purpose" of the appellant's trade, but merely an "effect" of it, or a "result". In the lastmentioned respect I would add the following observations. In dealing with section 11(a), my Brother FRIEDMAN says in his judgment: "Subject to the self-imposed constraints under which appellant operated within the Group context, appellant's business could be described as one consisting entirely of the borrowing of money and the lending of that money at a profit". With respect, I am in full accord with this description of the appellant's business, but, in my view, when it comes to applying the test of section 23(g), one must be on one's guard not to beg the question by simply elevating the words "at a profit" to the status of "purpose" and relegating the "self-imposed restraints" to the status of "result". In the context of section 23(g) I would say that the appellant's business consists entirely of the borrowing and the lending of money; that is its nature. What calls for determination then, is the relationship of that business vis-à-vis the promotion of the Group interests, on the one hand, and the making of a profit, on the other. On the evidence, I am unable to discern any qualitative difference between the one relationship and the other. The evidence shows plainly, in my opinion, that the appellant's business is wholly structured and conducted with a view to achieving both the promotion of the Group interests and the making of a profit. If the former is a "result", so is the latter; and if the latter is a "purpose", so is the former. In incurring expenditure by making loans the appellant pursues both aims simultaneously; the advantages accruing therefrom enure to the benefit of both the Group and the appellant; and in both instances they are "necessarily inherent in the act", irrespective of whether they are viewed as being "objectives" or "results". It is true that a profit is to be made always, and to that limited extent it may be said that the Group interests are subservient to the appellant's own interest. But that is neither here nor there. It does not render the promotion of the Group interests the less a "purpose" of the appellant's business. The concept of a "dominant purpose" has no role to play here.

Counsel for the appellant stressed that it is an everyday occurrence for the affairs of a subsidiary company within a group of companies to be so arranged as to serve the interests of the group. That is so, of course. But I do not see how it can avail the appellant. In every case where that occurs, and the question arises whether a particular item of expenditure is hit by section 23(g), the answer will have to be found by analyzing the particular facts of the case. Inter alia one would have to examine the nature of the activities carried on, the nature of the expenditure, and the closeness (or remoteness) of the connection between the expenditure and the benefit derived therefrom by the group. For example: in the present case the appellant presumably incurs ordinary day-to-day expenses in the running of its business, such as paying salaries to its employees, perhaps paying rental for the premises occupied by it, and so forth. There is no doubt that the deduction of such expenses from the appellant's income is not precluded by section 23(g). The reason for this is that the connection between such expenditure and the benefit to the Group flowing from the appellant's activities is too remote for the latter to qualify as a "purpose" in terms of the section. But the appellant's expenditure in the form of loans advanced to subsidiaries in the Group stands on quite a different footing. Such expenditure is part and parcel, the essential substance, in fact, of the very activities which were designed and carried out in order to benefit the Group, through the subsidiaries concerned. The connection between this expenditure and the benefit is both direct and immediate. In these particular circumstances the benefit falls within the ambit of the word "purposes" in the section.

Finally, I must refer to two hypothetical situations thought out and presented to us by counsel for the appellant, as analogously supporting his argument. The first is the case of a bookshop which is brought into being, and carries on business, with the object of promoting the sale of Christian literature and the spreading of the gospel; in order the better to achieve his aim, the bookseller cuts his profit margin on the sale of books to a minimum. If a customer buys a book on account and then fails to pay for it, counsel said, the bookseller could deduct the loss as a bad debt despite the "purpose" for which the business was being carried on. The other case is this: an African Bank is put up with the object of serving the interests of Black commerce; it does business only with Black entrepreneurs, and in advancing loans to such customers it charges interest far below the customary rate. The "purpose" of the bank's activities, counsel said, would not preclude it from deducting the loss of the amount of a loan which is not repaid. I shall assume that counsel is right in saying that in both cases the amounts in question are properly deductible. In my view, however, the situations postulated are not truly analogous to the facts of the present case. The vital points of distinction lie in the nature of the relationship between the bookseller and his customers and the bank and its customers, on the one hand, and the appellant and the Group, on the other. Taking the case of the bank and its customers first, it is clear that the bank operates as a completely independent trading concern. It is not tied to its customers, potential or actual, except to the extent that its activities do not go beyond a loosely specified and large class of persons. It is not obliged to do business with anyone. No one is obliged to do business with it. The bank and its customers deal with one another at arm's length. The same considerations apply to the case of the bookseller and his customers. But when we consider the relationship between the appellant and the Group the position is very different. The appellant is itself a member of the Group. It does not function independently. It is controlled, and its activities directed, as in the case of all the subsidiaries, by the holding company of the Group. The appellant and the subsidiaries with which it does business are knit together as members of one and the same family, and they deal with each other as such. The confines of the family are precisely defined with reference to the individual companies within the Group. The appellant and the other subsidiaries are obliged to do business with one another; they have no choice in the matter. The conclusion to be drawn from the above considerations, in my opinion, is that the connection between the activities of the appellant and the benefit conferred thereby on the Group is very substantially closer than the connection between the activities of the bookseller or the bank and the benefits conferred thereby on their respective customers. If it is accepted that in the latter situations the benefits are too remotely connected with the trading activities to be brought home under the word "purpose" in the section, I am nevertheless satisfied that the link between the appellant's activities and the furthering of the Group's interests is sufficiently close, on the evidence, to cause the latter to fall within the ambit of the word "purposes" as used in the section.

The order of the Court is that the appeal is dismissed with costs, including the costs of two counsel.

A.S. BOTHA JA

NICHOLAS AJA

CONCUR

NIENABER AJA

Case No 125/89
/MC

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Between

SOLAGLASS FINANCE COMPANY (PTY) LIMITED. Appellant

and

COMMISSIONER FOR INLAND REVENUE Respondent

CORAM: BOTHA, E M GROSSKOPF JJA et NICHOLAS, FRIEDMAN, NIENABER AJJA.

HEARD: 13 September 1990

DELIVERED: 30 November 1990.

J U D G M E N T

FRIEDMAN AJA.

FRIEDMAN AJA:

This is an appeal by a taxpayer (the appellant) against a decision of the Transvaal Income Tax Special Court. The appellant is a private company and a wholly owned subsidiary of Plate Glass Shatterprufe Industries Limited (PGSI), a public company quoted on the Johannesburg Stock Exchange. In submitting its income tax return in respect of the year of assessment ended 31 March 1978, appellant sought to deduct from its taxable income an amount of R4 545 922-00, being the loss incurred by appellant on what was described as "the disposal of a debtor". In respect of the year of assessment ended 31 March 1979 appellant sought to deduct amounts totalling R55 153-00, being losses sustained on loans which had become irrecoverable. In its income tax assessments for the years in question, respondent refused to allow these losses as deductions. Appellant objected and, its objection having been overruled, appealed to the Transvaal Income Tax Special Court. The latter court upheld the appeal against the assessment for the 1978 tax year, but only to the extent to which certain interest charged should have been allowed as a bad debt, and referred the matter back to the respondent for reassessment in accordance with the judgment. The appeal against the assessment for the 1979 tax year was dismissed. Leave having been granted by the President of the Special Court in terms of sec 86 A(5) of the Income Tax Act 58 of 1962 (the Act), appellant now appeals to this Court against the whole of the judgment of the Special Court, save to the extent to which appellant was successful in respect of the 1978 tax year.

The facts are not in dispute and may be summarised as follows. PGSI is the holding company of a group of companies known as the Plate Glass Group (the Group). PGSI's subsidiaries are of the order of 200, most of which are wholly owned by the parent company. The Group is involved in the manufacture, processing, wholesaling and retailing of timberwood and glass products. Until about 1973 the finances of each company in the Group were largely the responsibility of the particular company itself. In 1973 PGSI decided that the financial affairs of the Group would be best served by a finance company which would secure and arrange the funds required by all the companies in the Group. It would also monitor the use of those funds in the hands of the subsidiaries. In order to give effect to this decision a dormant subsidiary, previously called Plate Glass and Shatterprufe Industries Finance Company (Pty) Ltd, but whose name was subsequently changed to Solaglass Finance Company (Pty) Ltd (the present appellant), was utilised. One of appellant's objects, in terms of its memorandum of association, is to lend money to any person or company and to borrow such money as it deems fit. This object was not changed when the decision was taken to utilise appellant for the purposes contemplated. Henceforth, subsidiary companies requiring funds would apply to appellant which would, having regard to the budget of the subsidiary concerned, provide the necessary funds by way of loans. Security was not required on such loans. The subsidiaries were, however, required to pay interest on their loans. The rates varied, depending on the financial position of the subsidiary concerned, but generally the rates of interest charged were approximately 1% higher than appellant itself paid for moneys borrowed by it. Surplus funds in the hands of the subsidiaries were required to be placed with appellant on a daily basis. Appellant did not, however, rely solely on the surplus funds received from its fellow subsidiaries. It borrowed moneys from PGSI as well as from commercial banks, in the case of the latter by means of overdrafts and acceptance credit facilities. Loans obtained by appellant from banks would generally be guaranteed by PGSI.

Initially appellant's borrowings and lendings were confined to PGSI and the companies in the Group. Subsequently appellant's field of activities was extended: loans were made to staff members of companies in the Group and bills were discounted for customers of trading subsidiaries in the Group, in many instances with the object of enabling those customers to settle their accounts with the subsidiaries. Appellant also deposited moneys with building societies to enable staff members to obtain mortgage bonds.

The loss which appellant claimed to deduct from its taxable income for the year ending 31 March 1978 arose as follows. A company called P G Environmental Systems (Pty) Ltd (PGES), which was a subsidiary of PGSI, owed money on loan account to the holding company. According to the evidence of Mr Scott, the Group financial director and appellant's chief executive, who was the only witness called by appellant, this loan was "taken over" by appellant in

1973. How precisely this occurred was not spelt out in the evidence. Counsel were agreed, however, that the probabilities were that, when appellant entered upon the role determined for it by the holding company, PGES's loan account with PGSI was ceded to appellant and that appellant was substituted as debtor in the books of account of PGSI. The only available records of the loan in appellant's books of account commence with an opening balance of R5 853 826-58 on 1 April 1976. Interest was debited to the account of PGES from time to time, cash payments were made by PGES and further advances were made to it by appellant. According to Mr Scott the account was operated like a bank overdraft and it fluctuated on a regular basis. From about 1975 PGES's financial position started to deteriorate and it became evident that the business of PGES, as then structured, could not become viable. It was also realised that the major portion of the debt owing by PGES to appellant had become irrecoverable. On 21 November 1977 an agreement was concluded between PGSI, appellant, Afcol Manufacturing Ltd (Afcol) and PGES in terms of which Afcol took over control of PGES by subscribing for shares which ensured it a majority holding; it also took cession of appellant's loan account which, at the effective date of the agreement, stood at R5 980 759-00. The consideration paid for the loan, calculated in accordance with a formula provided in the agreement, amounted to R1 434 837-00. The balance of R4 545 922-00 was written off as irrecoverable. According to the uncontradicted evidence of Mr Scott, the consideration paid by Afcol exceeded the true value of the loan. The only alternative to the Afcol agreement would have been liquidation which would have resulted in a dividend of substantially less than the amount of R1 434 837-00 paid by Afcol for the loan.

The amount of R55 153-00 claimed as bad debts in respect of the 1979 tax year, is arrived at as follows:

Debtor	Amount
Midlothian Steel (Pty) Ltd	R20 242
Quality Kitchens (Pty) Ltd	R 4 547
M I Berkman	R29 233
C L Oosthuizen	R 453
C C van Wyngaardt	R 408
L Berkman	R 270
	R55 153

Midlothian Steel (Pty) Ltd and Quality Kitchens (Pty) Ltd, which were both in liquidation, were indebted to appellant in the amounts indicated, in respect of bills discounted which were subsequently dishonoured. The remaining debtors were all employees or ex-employees of subsidiaries to whom appellant had lent moneys. At the hearing of the appeal appellant's counsel informed the Court that the amount of R29 233-00 owing by M I Berkman was no longer in issue. That reduced the amount in issue in respect of the 1979 tax year, to R25 920-00. All these debts were written off as irrecoverable during the 1979 tax year. No portions thereof related to interest, which had been written back to interest received. Appellant's counsel conceded that, should the appeal in respect of these amounts succeed, it would be subject to appellant satisfying the respondent that there were adequate grounds for writing off the debts in question in the 1979 year of assessment.

In its income tax returns for the 1974 and 1975 tax years appellant claimed losses which it had incurred by reason of unfavourable changes in the rates of exchange between the South African rand and the Swiss franc, on loans obtained by appellant in Switzerland. These losses were disallowed. This led to an appeal by appellant to the Transvaal Income Tax Special Court and in due course an appeal to a Full Bench of the Transvaal Provincial Division. The judgment of the Full Bench is reported sub nom Plate Glass and Shatterprufe Industries Finance Co (Pty) Ltd v Secretary for Inland Revenue 1979(3) SA 1124(T). One of the questions which arose in that case was whether appellant was carrying on a banking or a money-lending business. The Full Bench agreed with the Special Court's finding that appellant was not carrying on such a business. It held that appellant's sole function was that of controlling and channelling funds available to the Group and that appellant had accordingly failed to discharge the onus of proving that the losses incurred by it in respect of deteriorating foreign exchange rates, were not of a capital nature.

In the present case the approach of the Special Court was that the Full Bench had held that appellant was not carrying on business as a banker or money-lender; that finding, on the facts found proved, was a question of law; if the activities of the appellant were not proved to have changed in the intervening years, the Court would be bound by the finding of the Full Bench. The judgment of the Special Court was therefore directed to the question whether the business and operations of the appellant during the 1978 and 1979 years of assessment differed from those in the 1974 and 1975 years of assessment. The Special Court's finding was that no significant change had occurred and that it had accordingly not been shown that the losses claimed were not of a capital nature. The losses were accordingly held to be not deductible.

The evidence in the present case was not the same as that in the previous case, and it was common cause, at the hearing before us, that this appeal fell to be decided on its own facts and that this Court was in no way bound by the judgment of the Full Bench in the previous case. It is therefore unnecessary to consider the previous case any further.

The amounts which appellant claims as

deductions from its taxable income for the 1978 and 1979 years of assessment are the losses it sustained as a result of loans having become irrecoverable. In other words, what appellant claims to have lost is the capital which formed the subject matter of these loans, and which has become irrecoverable.

Appellant relies, as the basis for its claim to be entitled to these deductions from its taxable income, on sec 11(a) of the Act which reads :

> "11. For the purpose of determining the taxable income derived by any person from carrying on any trade within the Republic, there shall be allowed as deductions from the income of such person so derived -
>
> (a) expenditure and losses actually incurred in the Republic in the production of the income, provided such expenditure and losses are not of a capital nature;"

It is common cause that this section must be read with its counterpart, sec 23(g), which provides that :

> "23. No deductions shall in any case be made in respect of the following matters, namely -
>
> (g) any moneys claimed as a deduction from income derived from trade, which are not wholly or exclusively laid out or expended for the purposes of trade;"

Sec 11(a) provides positively for what may, and sec 23 negatively for what may not, be deducted in the determination of a taxpayer's taxable income; a deduction claimed must satisfy both sections. See Commissioner for Inland Revenue v Nemojim 1983(4) SA 935(A) at 946-7.

Dealing first with section 11(a), what appellant has to establish is that (1) it was carrying on a trade; (2) the losses claimed were incurred in the production of income; (3) they are not of a capital nature. The Act contains in sec 1 a very wide definition of "trade" and there can be no doubt that the business which appellant was conducting falls within that definition. The second requirement also presents no difficulty: appellant's income consisted exclusively of interest earned on moneys lent by it in the course of its activities, and the losses were clearly incurred in the production of such income. The third requirement involves a consideration of the question whether the losses are of a capital or revenue nature.

The distinction between losses of a capital and those of a revenue nature, has been formulated in various ways. In New State Areas Ltd v Commissioner for Inland Revenue 1946 AD 613, WATERMEYER CJ, explained the distinction as follows at 620:

> "It has been pointed out before (see <u>Port Elizabeth Electric Tramway Co v Commissioner for Inland Revenue</u>, 1936 CPD 241) that in a literal sense expenditure and losses do not produce income. Save in the case of the leasing or the loan of capital in some form or other, income is produced by work or service or activities or operations and as a rule expenditure is attendant upon the performance of such operations sometimes necessarily, sometimes not. Expenditure may also occur in the acquisition by the taxpayer of the means of production, i.e., the property, plant, tools, etc., which he uses in the performance of his income earning operations and not only for their acquisition but for their expansion and improvement. Both these forms of expenditure can be described as expenditure in the production of the income but the former is, as a rule, current or revenue expenditure and the latter is, as a rule, expenditure of a capital nature."

And at 627 WATERMEYER CJ stated his conclusions on the various tests applied in order to determine into which of the two categories - capital or revenue - expenditure falls, as follows:

> "The conclusion to be drawn from all of these cases, seems to be that the true nature of each transaction must be enquired into in order to determine whether the expenditure attached to it is capital or revenue expenditure. Its true nature is a matter of fact and the purpose of the expenditure is an important factor; if it is incurred for the purpose of acquiring a capital asset for the business, it is capital expenditure, even if it is paid in annual instalments; if, on the other hand it is in truth no more than part of the cost incidental to the performance of the income-producing operations, as distinguished from the equipment of the income-producing machine, then it is revenue expenditure, even if it is paid in a lump

sum."

As what appellant lost was the capital which it advanced to the various debtors and which has become irrecoverable, it is necessary to decide whether the capital thus lost was fixed or floating (sometimes called circulating) capital. If it was fixed capital, the loss was of a capital nature; if it was floating, the loss was of a revenue nature. See Stone v Secretary for Inland Revenue, 1974(3) SA 854(A) at 595A-B.

The distinction between fixed and floating or circulating capital was explained by INNES CJ in Commissioner for Inland Revenue v George Forest Timber Co Ltd 1924 AD 516 at 524, as follows:

"Capital, it should be remembered, may be either fixed or floating. I take the substantial difference to be that floating capital is consumed or disappears in the very process of production, while fixed capital does not; though it produces fresh wealth, it remains intact."

See also the New State Areas case, supra, at 620-1 where WATERMEYER CJ, after quoting the above passage, stated:

"As to the latter (expenditure of a capital nature), the distinction must be remembered between floating or circulating and fixed capital. When the capital employed in a business is frequently changing its form from money to goods and *vice versa* (e.g. the purchase and sale of stock by a merchant or the purchase of raw material by a manufacturer for the purpose of conversion to a manufactured article), and this is done for

> the purpose of making a profit, then the capital so employed is floating capital. The expenditure of a capital nature, the deduction of which is prohibited under sec 11(2), is expenditure of a fixed capital nature, not expenditure of a floating capital nature, because expenditure which constitutes the use of floating capital for the purpose of earning a profit, such as the purchase price of stock in trade, must necessarily be deducted from the proceeds of the sale of stock in trade in order to arrive at the taxable income derived by the taxpayer from that trade."

In Ammonia Soda Co v Chamberlain (1918) 1 Ch D 266 SWINFEN EADY LJ defined fixed capital as follows at 286:

> "That which a company retains, in the shape of assets upon which the subscribed capital has been expended, and which assets either

> themselves produce income, independent of any further action by the company, or being retained by the company are made use of to produce income or gain profits."

At 286-7 he described circulating capital in the following terms:

> "It is a portion of the subscribed capital of the company intended to be used by being temporarily parted with and circulated in business, in the form of money, goods or other assets, and which, or the proceeds of which, are intended to return to the company with an increment, and are intended to be used again and again, and to always return with some accretion. Thus the capital with which a trader buys goods circulates; he parts with it, and with the goods bought by it, intending to receive it back again with profit arising from the resale of the goods. A banker lending money to a customer parts with his money, and thus circulates it, hoping and intending to receive it back with

interest."

In _Stone_'s case, _supra_, CORBETT AJA, with reference to the distinction drawn in the _New State Areas_ case and the _George Forest Timber Company_ case between fixed and floating capital, said the following at 595G-596A:

> "Applying the distinction, thus described, to the ordinary case of a loan of money, there is no doubt, in my opinion, that the capital lent constitutes fixed capital. Such capital is not consumed in the very process of income production: it does not disappear to be replaced by something which when received by the taxpayer forms part of his income. It is true that the lender does not retain ownership in the actual money which passes but, in an economic and accounting sense, it remains his capital and upon the termination of the loan (all being well) it

returns to him intact. In the process wealth may be produced for the lender but this takes the form of a consideration, usually in the form of interest, paid by the borrower for the use of the capital; it does not consist of the augmented proceeds of the capital, which itself has disappeared in the process."

The position is, however, different when a loan is made in the course of his business by a money-lender or banker. There have been several cases in our courts where it has been held that if a taxpayer can show that he has been carrying on the business of banking or money-lending, losses incurred by him as a result of loans made by him in the course of such business becoming irrecoverable, constitute losses of a non-capital nature and are accordingly deductible. In <u>Stone</u>'s case, <u>supra</u>, CORBETT AJA at 596A-B referred to a number of the cases in the Special Court where this proposition was accepted. To those could be added the Ammonia Soda Co case, supra at 286-7 and Read's Brewery Co Ltd v Male [1891] 2 QB 1.

Whether or not a taxpayer can be said to be carrying on the business of a money-lender or banker is in each case a question of fact to be decided in the light of the circumstances of the particular case. The following are guidelines which have been laid down for the determination of the question whether a taxpayer can be said to be carrying on such a business:

1. There must be an intention to lend to all and sundry provided they are, from his point of view, eligible. See Secretary for Inland Revenue v Crane 1977(4) SA 761(T) at 768D-E.
2. The lending must be done on a system or plan which discloses a degree of continuity in

laying out and getting back the capital for further use and which involves a frequent turnover of the capital. See Income Tax Case No 1138, 32 SATC 3 at 6; Income Tax Case No 812, 20 SATC 469 at 473; Income Tax Case No 933, 24 SATC 347 at 348; and Crane's case supra, at 768D-E.

3. The obtaining of security is a usual, though not essential, feature of a loan made in the course of a money-lending business. See Income Tax Case No 999, 25 SATC 183 at 186; Income Tax Case No 1003, 25 SATC 237 at 239; Income Tax Case No 1138, 32 SATC 3 at 6.

4. The fact that money has on several occasions been lent at remunerative rates of interest, is not enough to show that the business of money-lending is being carried on; there must be a certain degree of continuity and system about the transactions. See Income Tax Case No 812, 20 SATC 469.

5. The proportion of the income from loans to the total income: the smallness of the proportion cannot, however, be decisive if the other essential elements of a money-

lending business exist. See Income Tax Case No 1138, 32 SATC 3 at 6; Income Tax Case No 979, 25 SATC 44 at 46.

In Stone's case, supra, CORBETT AJA referred to these and other cases and went on to state at 596B-D:

> "The rationale of these decisions appears to be that the capital used by a money-lender to make loans constitutes his circulating capital and that consequently losses of such capital are on revenue account. I shall accept, for the purposes of this case, that these decisions are correct, provided that the business is purely that of money-lender and the loans are not made in order to acquire an asset or advantage calculated to promote the interests and profits of some other business conducted by the taxpayer (cf Atlantic Refining Company of Africa (Pty) Ltd v C I R 1957(2) SA 330 (AD)). There is, however, in my view, no warrant for extending this principle to loans by persons who are

not conducting a money-lending business."

As I understand this statement, the learned judge intended, by the proviso which he attached to his acceptance of the correctness of these decisions, that such acceptance should apply only in the case of loans made by a banker or money-lender in the course and for the purposes of that business, and not for the purpose of the advancement of another business conducted by the taxpayer. This follows, as I see it, from the reference to the Atlantic Refinery case, where a loan was advanced by a wholesale supplier of petrol and petroleum products and where the "decisive inducement" for making the loan, was not to recover a reward in the form of interest, but to acquire a "tie" i.e. an agreement with a distributor restricting the latter's right to trade in petrol and petroleum products, to products of the supplier, to the exclusion of all such supplier's competitors.

Appellant's counsel argued, on the strength inter alia of the authorities referred to in Stone's case, that appellant was conducting the business of a banker or money-lender or a business "sufficiently similar to and analogous with" such a business, and that the losses were accordingly losses of floating or circulating capital and were thus deductible from appellant's taxable income in terms of sec 11(a) of the Act. Respondent's counsel, on the other hand, contended that appellant was not conducting the business of a banker or money-lender; it was, he argued, merely carrying on an administrative business and its income was derived from the managerial functions it performed in the course thereof. Counsel argued that what distinguished appellant from a money-lending company, were the following:

1. Appellant's dominant motive was to assist the Group.
2. Appellant had no system of structuring its business to ensure that it made a profit.
3. Security was not taken on loans.
4. Loans were not made to all and sundry, but only to "an elitist element".
5. Financial considerations were not taken into account in deciding whether to make a loan; it was the Group interests which were decisive, the intention being to provide a support system for appellant's associated companies in the Group.

There is no gainsaying the fact that appellant does not fall within the ambit of all the guidelines referred to above. It does not, for example, lend to all and sundry; it does not seek to obtain security for the loans which it advances; its business is not structured to maximise profits. On the other hand, appellant's sole business consists of borrowing moneys and utilising the moneys so acquired for making loans, albeit only to companies in the Group, to staff members and customers of trading companies in the Group. This business was moreover conducted on an extensive scale. Appellant's balance sheet as at 31 March 1978 reveals that, as at that date, the amounts owing to appellant by fellow subsidiaries amounted to R43 848 258-00 and by "other" borrowers, R4 070 325-00. The corresponding figures according to appellant's balance sheet as at 31 March 1979, were R45 167 389-00 and R2 081 881-00 respectively. Appellant's income statement for the year ending 31 March 1978 reveals that interest received amounted to R6 506 250-00 made up as follows:

Fellow subsidiary companies	R5 784 946
Other	R 721 304

Interest received for the year ending 31 March 1979 amounted to R5 003 203-00 which was made up as follows:

Fellow subsidiary companies	R4 716 004
Other	R 286 599

Interest paid for the years ended 31 March 1978 and 31 March 1979, amounted to R5 702 898-00 and R4 530 387-00 respectively, which amounts were made up as follows:

	1978	1979
Holding and fellow subsidiary companies	R4 031 782	R2 795 341
Other	R1 735 049	R1 671 116

These figures show that the interest received in these two years exceeded the interest paid by R803 352-00 in 1978 and R472 816-00 in 1979.

The extent of the borrowing and lending activities in which appellant was involved, appears also from the sources and application of appellant's funds in respect of the years of assessment, which were as follows:

Sources of funds	1978	1979
- Loans from Holding Co. and fellow subsidiaries	R39 965 002	R39 896 714
- Loans from other parties...........	R 4 062 225	R 8 957 585
- Acceptance credit loans	R 7 908 853	R 3 387 252
	R51 936 078	R52 241 551

Application of funds		
- Loans to subsidiaries and associated companies	R45 025 931	R46 289 389
- Loans to other parties		
Staff members ..	R 351 880	R 236 113
Building Society deposits	R 121 700	R 111 700
Bills discounted	R 160 243	R 546 468
Sundry loan ...	R 665 012	R 667 174
	R46 304 766	R47 850 844

The fact that appellant's monthly turnover was, according to Mr Scott, of the order of R30 million, involving a large number of transactions, provides a further illustration of the extent of the borrowing and lending in which appellant was involved.

I do not agree with the submission made by respondent's counsel that financial considerations were not taken into account in deciding whether to make a loan. According to Mr Scott funds were not made available merely for the asking. The subsidiaries were required to prepare budgets; based on these, appellant made funds available to the subsidiaries to enable them to operate within their budgets, in accordance with borrowing limits set by Mr Scott himself. Although, according to Mr Scott, appellant's philosophy was "to be supportive and back the aims of the Group"-

> "In the structuring and design of the method whereby it performed this function it sought at all times to make a profit by the process of securing funds at a lesser average rate than the rate at which it lent funds to its fellow subsidiaries in respect of the acquisition of Bills Receivable, and even in fact, in the majority of instances to the lending of money to members of staff."

All the subsidiaries paid interest on their loans, but the interest rates varied from company to company. Mr Scott explained the reason for this as follows:

> "In terms of its basic lending and operational philosophy, my lord, the lending was conducted for two reasons firstly, to ensure there was a profit overall on average

> cost of money to average cost of lending money, but at the same time the interest of the borrowing company as a member of the group of companies was borne in mind and there were occasions when loans at lower rates of interest were made to companies that were not performing perhaps as well as others."

Subject to the self-imposed constraints under which appellant operated within the Group context, appellant's business could be described as one consisting entirely of the borrowing of money and the lending of that money at a profit. Because of these constraints, there are features of appellant's business which are not normally found in an ordinary, commercial money-lending business. Non constat, however, that the business conducted by appellant is not that of money-lending. To my mind, that is exactly what appellant is doing. In the circumstances the capital utilised by appellant for this purpose is, in my judgment, not fixed, but circulating capital. It is obtained for one purpose and one purpose only, namely that of parting with it temporarily in the form of loans, in the expectation of receiving it back with an increment in the form of interest. The capital which appellant lost as a result of being unable to recover the loans, was therefore of a revenue nature. The losses in question were accordingly deductible in terms of sec 11(a).

It remains to be considered whether the losses are disqualified from deduction by reason of the provisions of sec 23(g). According to that section no deduction shall be made in respect of moneys claimed as a deduction from income derived from trade which are not "wholly or exclusively laid out or expended for the purposes of trade".

The moneys claimed as deductions represent, as indicated above, the capital lost by appellant as a result of the loans becoming irrecoverable. Two questions arise, namely (a) were those moneys "laid out" or "expended" within the meaning of sec 23(g); and if so, (b) were they wholly or exclusively laid out for the purposes of trade?

When money which is advanced by way of a loan, becomes irrecoverable, the taxpayer incurs a "loss". It was argued on behalf of appellant that the word "loss" does not necessarily mean the same as "expenditure" (the word used in sec 11(a)) and that sec 23(g) does not apply to a loss caused to a taxpayer as a result of his becoming unable to recover a loan made by him, which loss would otherwise be deductible in terms of sec 11(a). In view of the conclusion I have reached on the second question I find it unnecessary to decide whether or not it can be said that the moneys in question were "laid out" or "expended" within the meaning of sec 23(g) of the Act. I shall assume that they were. The next question then is whether the moneys were so laid out or expended "wholly or exclusively for the purposes of trade". This involves a consideration of what is meant by these words.

There is a similarly worded provision in the English tax legislation which reads as follows:

> "... in computing the amount of the profits or gains to be charged .... no sum shall be deducted in respect of (a) any disbursements or expenses, not being money wholly and exclusively laid out or expended for the purposes of trade, profession, employment or vocation ...."

The English Court of Appeal had occasion to consider the meaning of the words "wholly and exclusively laid out or expended for the purposes of trade ...." in Bentleys, Stokes and Lowless v Beeson (H M Inspector of Taxes) [1952] 33 TC 491; [1952] 2 All ER 82 (CA). The issue in the Bentleys case was whether the taxpayers, who were members of a firm of solicitors, were entitled to a deduction in respect of expenses incurred in entertaining clients. The clients were entertained to lunch, during which business interviews were conducted. The clients were charged fees for the legal advice given, but the lunches were charged by the taxpayers as an expense against the firm's income. ROMER LJ, in delivering the judgment of the court, said the following at 503-4 (33 TC) ([1952] 2 All ER at 84G-85B):

> "The relevant words .... 'wholly and exclusively laid out or expended for the purposes of the profession' - appear straightforward enough. It is conceded that the first adverb- 'wholly' -is in reference to the quantum of the money expended and has no relevance to the present case. The sole question is whether the expenditure in question was 'exclusively' laid out for business purposes, that is: What was the motive or object in the mind of the two individuals responsible for the activities in question? It is well established that the question is one of fact: and again,

therefore, the problem seems simple enough. The difficulty however arises, as we think, from the nature of the activity in question. Entertaining involves inevitably the characteristic of hospitality. Giving to charity or subscribing to a staff pension fund involves inevitably the object of benefaction. An undertaking to guarantee to a limited amount a national exhibition involves inevitably supporting that exhibition and the purposes for which it has been organised. But the question in all such cases is: Was the entertaining, the charitable subscription, the guarantee, undertaken solely for the purposes of business, that is, solely with the object of promoting the business or its profit earning capacity?

It is, as we have said, a question of fact. And it is quite clear that the purpose must be the sole purpose. The paragraph says so in clear terms. If the activity be undertaken with the object both of promoting business and also with some other purpose, for example, with the object of indulging an independent wish of entertaining a friend or stranger or of supporting a charitable or benevolent object, then the paragraph is not satisfied though in the mind of the actor the business motive may predominate. For the statute so prescribes. Per contra, if in truth the sole object is business promotion, the expenditure is not disqualified because the nature of the activity necessarily involves some other result, or the attainment or furtherance of some other objective, since the latter result or objective is necessarily inherent in the act."

On the facts of that case, the Court of Appeal held that the expenses in question were deductible; the element of hospitality involved did not, so it was held, constitute a dual purpose with the professional purpose involved.

The words "wholly and exclusively laid out or expended for the purposes of the trade ...." were subsequently considered by the House of Lords in Mallalieu v Drummond (Inspector of Taxes) [1983] 2 All ER 1095. The taxpayer was a female barrister who claimed, as a deduction, the expenditure incurred by her on the replacement, cleaning and laundering of certain items of clothing which she wore in court. In considering the words of the tax provision, LORD BRIGHTMAN said at 1099e-f that they mean "expended to serve the purposes of the trade ...." or "for the purpose of enabling a person to carry on and earn profits in the trade ...". His Lordship proceeded, at 1099g-h, to state:

"The effect of the word 'exclusively' is to

> preclude a deduction if it appears that the expenditure was not only to serve the purposes of the trade, profession or vocation of the taxpayer but also to serve some other purposes. Such other purposes, if found to exist, will usually be the private purposes of the taxpayer."

To ascertain whether the money was expended to serve the taxpayer's business, it was necessary, according to LORD BRIGHTMAN, "to discover the taxpayer's 'object' in making the expenditure" by looking into the taxpayer's mind at the moment when the expenditure was made. At 1099j - 1100a LORD BRIGHTMAN continued as follows:

> "If it appears that the object of the taxpayer at the time of the expenditure was to serve two purposes, the purposes of his business and other purposes, it is immaterial

to the application of s 130(a) that the business purposes are the predominant purposes intended to be served.

The object of the taxpayer in making the expenditure must be distinguished from the effect of the expenditure. An expenditure may be made exclusively to serve the purposes of the business, but it may have a private advantage. The existence of that private advantage does not necessarily preclude the exclusivity of the business purposes."

The appeal was therefore, said LORD BRIGHTMAN at 1100d "basically concerned with the distinction between object and effect". The taxpayer in Mallalieu's case was held to have two objects, namely to serve the purposes of her profession and to serve her own purposes and the deduction was therefore not allowed.

In Commissioner for Inland Revenue v Pick 'n

Pay Wholesalers (Pty) Ltd 1987(3) SA 453(A) this Court adopted the analysis of ROMER LJ in the Bentleys case, and referred also to the distinction between the object of expenditure and its effect as outlined in LORD BRIGHTMAN's speech in Mallalieu's case. Applying the principles thus enunciated, this Court held that the taxpayer who had made a large charitable donation which it sought to deduct from its income as an "advertising" expense, had not shown that, in making the donation, it did not have a dual purpose, namely a philanthropic as well as a business purpose; the deduction was therefore disqualified by the provisions of sec 23(g).

In the present case the business of the appellant was, in a general sense, that of banker or financier to the Group. In the course of that business, it borrowed and lent out moneys in accordance with the financial requirements of the members of the Group, its business activities subsequently being expanded to encompass loans to employees of the Group and the discounting of bills for customers of the trading companies in the Group. The purpose of the business which appellant so conducted in accordance with the decision taken by its controlling shareholder, was to make a profit out of the loans it made and the bills it discounted. The loans were all advanced and the bills discounted in the furtherance of that purpose. The fact that the making of the loans and the discounting of the bills involved another result, namely that of providing a benefit to the Group - which result was inherent in the expenditure in question - does not disqualify appellant from claiming the deductions.

Mr Scott did not, in his evidence, seek to hide the fact that appellant was "not totally independent". He explained this as follows:

> "The aims, my lord, of this company were several, but the principal objective was by means of consolidating third party debts to secure the most advantageous terms and conditions for borrowings whilst at the time organizing and ensuring the availability of finance for the group's subsidiaries. But within the structure of those motives the company was designed to secure profit for itself."

It is by no means uncommon, in a large group of companies, for the business of the group to be rationalised in such a way that the activities of each subsidiary are structured with the interests of the group in mind. If the sole object of an expenditure by a subsidiary is the promotion of its business, the expenditure would not, as ROMER LJ pointed out in the <u>Bentleys</u> case, be "disqualified because the nature of the activity necessarily involves some other result, or the attainment or furtherance of some other objective" which is "necessarily inherent in the act".

The losses which form the subject matter of the present appeal, all arose out of expenditure incurred by appellant for the purposes of its trade as a money-lender. The fact that the loans were made necessarily resulted in an advantage to the Group. That result did not, however, constitute a "purpose" different from that of promoting the business which appellant was itself conducting. That being so, the losses in question were not, in my judgment, disqualified as deductions by reason of sec 23(*g*).

It appears from the judgment of the Special Court, that the consideration received by appellant from Afcol for the PGES loan, was appropriated by appellant solely to capital. The full amount of interest charged since 1 April 1976 was consequently reflected as unpaid. The Special Court dismissed the argument advanced on behalf of the Commissioner that appellant was not entitled to appropriate the payment it received, in the manner in which it had done. The Commissioner's representative had apparently conceded, however, that if the Special Court dismissed that argument, the amount of interest charged to the account should have been allowed as a bad debt in terms of sec 11(i) of the Act. It was not clear how much that interest amounted to and the matter was accordingly referred back to the Commissioner for re-assessment in accordance with the findings of the Special Court. In the light of the conclusion I have reached, it would not be necessary to calculate the interest separately: on the view I take the whole amount of the loss in respect of the PGES loan is deductible.

I would uphold the appeal with costs, including the costs consequent upon the employment of two counsel, and substitute an appropriate order for that made by the Transvaal Special Income Tax Court.

G. FRIEDMAN AJA.

E.M. GROSSKOPF concurs.