CASE NO. 437/92 J
VD M

IN THE SUPREME COURT OF SOUTH AFRICA

(APPELLATE DIVISION)

In the matter between:

CONSHU (PTY) LTD — APPELLANT

and

THE COMMISSIONER FOR INLAND REVENUE — RESPONDENT

CORAM: HOEXTER, E M GROSSKOPF, NESTADT, HARMS JJA et OLIVIER, AJA

HEARD: 5 AND 25 MAY 1994

DELIVERED: 2 SEPTEMBER 1994

J U D G M E N T

HARMS, JA:

This appeal concerns the interpretation of s 103(2) of the Income Tax Act 58 of 1962 ("the Act").

The crisp question for decision is whether in the circumstances of this case the Commissioner for Inland Revenue, not having applied the provisions of the sub-section during the tax year in which an agreement of the kind referred to in this section was entered into, is entitled to apply it in respect of an ensuing tax year.

The taxpayer, Conshu (Pty) Ltd (the present appellant), was formerly known as National Tyre Company (Pty) Ltd. The end of its tax year has always been 30 June. During the tax 1984 year the nature of its business was that of a tyre retreader and dealer; it suffered a loss of some R3,3m and, taking into account its accumulated assessed loss, the Commissioner determined the new balance of the assessed loss at R5 856 947. The appellant conducted the same type of business during 1985. Its trading results were poorer still. In consequence of and due to pressure from its bankers it was obliged to take drastic steps. That was done towards the end of the tax year. They were:

(a) a change of name on 19 June 1985 to Conshu Holdings (Pty) Ltd. In doing so it took over the name of another company and the erstwhile Conshu Holdings (Pty) Ltd then changed its name to United-Fram Footwear Manufacturers (Pty) Ltd ("United-Fram"). (The "Holdings" part of the name of the appellant fell away on a later date.) United-Fram had been a footwear manufacturer and distributor;

(b) a change in the shareholding of the appellant. The date was not given but it must have been at about the same time. The change was part of a reorganisation of the Calan group of companies of which the appellant had been a member;

(c) the acquisition of all the trading assets and liabilities of United-Fram. It was alleged that this took place on 30 June - the last day of the financial year and a Sunday;

(d) the disposal of the bulk of its business. Only the solid tyre business was retained, which in the scheme of things, was a relatively small part of its business.

As a result of these changes, the nature of the appellant's business was described in the 1985 return of income as that of retreader and distributor of pneumatic and solid tyres, manufacturers of rubber footwear, other footwear and related products. The return also reflected the effect of the disposal as well as the result of the purchase of the trading assets and liabilities of United-Fram. The tax calculation that formed part of the audited accounts for the year ending 30 June 1985 had these salient features:

Net loss per income statement	5 728 732
Less: depreciation, doubtful debt allowance (1984), provision for bad debts etc	940 278
	4 788 454
Add: initial allowance, profit on disposal of fixed assets etc	121 251
	4 909 705
Assessed loss brought forward	5 856 947
Estimated assessed loss	10 766 652

The Commissioner dealt with the 1985 return in the following manner. He issued an original assessment during 1986 and assessed the loss in accordance with the accounts to be R10 766 652. Some two years later an additional assessment was issued. Its purpose was to add back an initial allowance incorrectly claimed on the purchase of the capital goods from United-Fram. In the result the assessed loss for 1985 was reduced to R9 853 212. This assessment has not since been reopened.

The changes effected to the appellant's business during 1985 had the desired result and the income tax return for the 1986 tax year reflected in its tax calculation this conclusion:

Taxable income for the year	6 549 842
Assessed loss brought forward	(10 766 652)
Assessed loss to be carried forward	(4 216 810)

In other words, the appellant sought to utilise the provisions of s 20 of the Act in the determination of its taxable income by setting off against the 1986 income the balance of the assessed loss which had been carried forward from the 1985 year. In the original assessment for 1986 the Commissioner allowed the appellant's claim to a set-off (save that due to some minor adjustments the income was assessed at R6 700 468 and the resultant loss at R4 066 184).

During the course of 1988 the Commissioner

issued two revised assessments in relation to 1986 simultaneously. The one was a "reduced" and the other an "additional" assessment. The reason and their nature appear from a letter dated 27 June 1988. In it the Commissioner informed the appellant that he was satisfied that the transaction whereby the assets of "various footwear companies" (presumably United-Fram) had been transferred to it had been entered into "solely or mainly for the purposes of the postponement of the liability for the payment of income tax". Invoking the provisions of s 103 (and without limiting himself to sub-section (2)), he then ruled that the appellant was not permitted to utilise the 1985 assessed loss against the income derived during 1986 from the transferred assets. In consequence the "reduced" assessment amounted to this:

Assessed loss available from 1985	(9 853 212)
less Income from old business	2 211

Balance of assessed loss	(9 851 001)

The "additional" assessment dealt with the so-called "tainted" income, i e income derived from the transferred assets, in the following manner. The taxable income was calculated by deducting the R2 211 income produced by the solid tyre business from the net income. After some adjustments (which are not germane) had been made, the taxable income was assessed at R6 812 438.

The appellant was dissatisfied with the ruling and noted an objection which was rejected. An appeal to the Income Tax Special Court was then lodged. Whilst it was pending, the Commissioner informed the appellant by letter dated 4 October 1990 that although his decision had been to apply both s 103(1) and s 103(2) and although he was still of the opinion that he had been entitled to issue a valid assessment in that way, he had now decided to abandon his right to invoke ss (l);

and accordingly gave notice that he would argue the matter in terms of ss (2) only.

It is not necessary to deal with the grounds of appeal as originally filed because the special Court at the first hearing granted leave to the appellant to supplement its notice of appeal by the introduction of two further, and alternative, grounds; and at the second hearing leave was granted to have the first of these heard and disposed of separately. That was done pursuant to the provisions of the Magistrates' Courts Rule 19(12) which allows for a separate hearing of a defence which can be adjudicated upon without the necessity of going into the main case.

This ground was apparently reformulated during the course of argument in the Special Court in these terms:

> "The Commissioner should have applied the provisions of section 103 (2) of the Act in the

assessment that he raised for the year in which the agreement was entered into and in which it took effect, namely the year ended 30 June 1985. Once the Commissioner had failed to apply the provisions of section 103(2) in respect of the 1985 year of assessment, it was not competent for him to endeavour to apply the provisions of the sub-section for the first time in respect of the 1986 year, as he purported to do in the revised assessment."

For the purpose of deciding this issue, the Special Court was asked to make three assumptions:

(1) that there had been an agreement and a change in shareholding affecting the appellant. (There was no actual evidence that the agreement had been entered into on 30 June 1985 or that it had in fact been concluded during that tax year. The Court was also not asked to make that assumption but by implication did so. Because of my conclusion in the matter I shall deal with it on

the same footing.)

(2) that the agreement had been entered into and the change in shareholding effected for the purpose of utilising the assessed loss of the appellant in order to avoid liability on the part of the appellant for the payment of tax.

(3) that there had been no reduction in the appellant's tax liability in the 1985 year as a result of the transaction. The first time a difference was caused was in 1986. (The scope and meaning of this last assumption became contentious during argument and I shall return to it in due course.)

At the hearing only the evidence of Mr C Rapp was led. He was the financial director of the appellant at the time of the appeal but he had no personal knowledge of the events in issue. He interpreted the financial statements of the appellant.

The Special Court (presided over by Melamet AJ) dismissed the preliminary ground of appeal and postponed the hearing of the other grounds indefinitely. The appellant preferred to obtain a final determination of this point and, with the leave of the President, appealed directly to this Court. In its notice of appeal, the appellant joined issue with the Special Court on its interpretation of the sub-section and noted that the sole issue in the instant case concerned the time when the Commissioner was entitled to exercise his discretionary powers.

Counsel for the appellant began his address to this Court with the argument that the appeal had to succeed because there was no evidence on record to show that the Commissioner in fact had formed the opinion that one of the prerequisites for the application of s 103(2) had been present. The sub-section requires that the Commissioner must be satisfied that the purpose of the agreement must have been to "avoid" tax before he can disallow the set-off of an assessed loss against tainted income. That was, according to the argument, absent. Counsel for the Commissioner also raised a new issue, namely his entitlement to rely at some stage or other on ss (1) in addition to his argument on ss (2). I have been at some pains to indicate what the case is all about and there can be no doubt that these points are not matters which we should or can decide.

Before proceeding to s 103(2), it is necessary to return to the third assumption referred to earlier i e that there had been no reduction in the appellant's tax liability in the 1985 year as a result of the transaction. Respondent's counsel submitted that it meant that no tainted income had been received by or had accrued to the appellant during that year. The Special Court noted that it was common cause that "income in the generally accepted meaning of the term from the acquisition of the assets had been earned for the first time in the 1986 year of assessment". Melamet AJ went on to state that:

> "(c)ertain items included in the 'gross income' reflected in the financial statements accompanying the appellant's return to the Commissioner for Inland Revenue for the 1985 year of assessment, in terms of the provisions of the Income Tax Act and accounting practices flow from the agreement e g the inclusion of the assets acquired as 'trading stock', adjustments to the provisions for 'bad debts' and 'doubtful debts', the initial allowance claimed in respect of plant and machinery acquired and recoupment resulting from the sale by the appellant of certain of its assets".

In my view the Special Court erred for the reasons that follow. As mentioned earlier the initial allowance claimed had been disallowed by the Commissioner. The recoupment resulting from the sale of assets was a reference to the sale by the appellant of its retreading business to three subsidiaries of Voltex

Electrical SA (Pty) Ltd. The evidence does not support the proposition that this sale was part and parcel of the tainted transaction. Mr Rapp referred to two distinct transactions, the purchase of the United-Fram assets and this sale. The only documentary "evidence" was the production of company resolutions concerning the United-Fram acquisition. It will be also recalled that the transaction which is the subject of the ruling by the Commissioner related only to the transfer of assets to the appellant. The adjustments to the provision of bad and doubtful debts were also a consequence of the Voltex transaction. As far as the trading stock is concerned, it had in part been obtained from United-Fram and was reflected as part of the appellant's closing stock at cost. It had to be taken "into account" in terms of s 22(1) of the Act in the determination of the appellant's taxable income. That did not elevate it to income within either the ordinary or the defined meaning of the word - an aspect to which I shall revert (cf Divaris & Stein, Silke on South African Income Tax, § 8.111).

In the result I am of the view that although the last assumption did not have the meaning ascribed to it on behalf of the Commissioner, there was no evidence that any tainted "income" (defined or otherwise) had been earned during 1985. It would appear that there was some misconception as to the nature of the proceedings before the Special Court. It was in the nature of a hearing on a special plea. That meant that the appellant had to prove all the facts necessary for the success of his case, i e the upholding of the appeal to that Court. The relevant Rule 19(12) does not contemplate a piecemeal decision of the special defence.

Turning then to the interpretation of s 103(2), it reads:

> "Whenever the Commissioner is satisfied that any agreement affecting any company or any change in the shareholding in any company <u>or in the member's interest in any company which is a close corporation</u>, as a direct or indirect result of which income has been received by or has accrued to that company during any year of assessment, has at any time before or after the commencement of the Income Tax Act, 1946, been entered into or effected by any person solely or mainly for the purpose of utilizing any assessed loss incurred by the company, in order to avoid liability on the part of that company or any other person for the payment of any tax, duty or levy on income, or to reduce the amount thereof, the set-off of any such assessed loss or balance of assessed loss against any such income shall be disallowed."

(The words underlined were introduced by s 37(a) of the Income Tax Act 121 of 1984. The section before the amendment applied to the appellant's tax year of 1985 and the amended version to that of 1986 - see s 50(1). This amendment has no effect on the issue under consideration.)

The object of this provision was thus stated by D M Stewart, The Prohibition of Tax Avoidance : An Evaluation of Section 103 of the South African Income Tax Act (No 58 of 1962), (1970) 3 CILSA 168 at 189:

> "The reason for this subsection is that elsewhere in the Act [s 20] it is recognised that to divide a taxpayer's business up into separate yearly compartments is largely artificial, and, as a result, where in one year allowable deductions exceed income, the taxpayer may carry the balance of deductible excess forward as an 'assessed loss.' This loss may be deducted from income earned in the next or a subsequent year. As a result, certain taxpayers, whose businesses have failed to profit, build up large assessed losses. Where these taxpayers are individuals the Revenue has nothing to fear for the assessed loss is not itself transferable, but where the taxpayer is a company, whose shares can readily change hands, new proprietors will attach themselves to the company and inject new income into it in order to exploit the assessed loss. It is this 'trafficking' in the shares of companies with assessed losses which gave rise to the enactment

Of section 103 (2)."

In Glen Anil Development Corporation Ltd v Secretary for Inland Revenue 1975 (4) SA 715 (A) 727H-728A Botha JA, in a judgment dealing with the interpretation of s 103(2), stated:

> "Sec 103 of the Act is clearly directed at defeating tax avoidance schemes. It does not impose a tax, nor does it relate to the tax imposed by the Act or to the liability therefor, but rather to schemes designed for the avoidance of liability therefor. It should, in my view, therefore, not be construed as a taxing measure but rather in such a way that it will advance the remedy provided by the section and suppress the mischief against which the section is directed ... The discretionary powers conferred upon the Secretary should, therefore, not be restricted unnecessarily by interpretation."

On the other hand, Schreiner JA in a concurring judgment in Commissioner for Inland Revenue v I H B King; Commissioner for Inland Revenue v A H King 1947 (2) SA

196 (A) 216, said in this regard:

> "I do not read sec. 90 [of the Income Tax Act 31 of 1941] as a penalty section or as widening the net beyond the general scope of the Act. It seems to aim at a truer or fairer determination of the liability to the taxes imposed by the Act and their due payment when so determined. It is intended, I think, to deal with cases in which the Commissioner, as representing the <u>fiscus</u>, is properly aggrieved by a transaction or operation designed to enable one of the parties thereto to escape tax. The Commissioner is not properly aggrieved merely because at a stage before income has accrued to a taxpayer it might have been predicted with confidence, amounting even to certainty, that if the taxpayer took no steps in the matter such income would accrue to him, and because he then takes the avoiding steps. But the Commissioner would be properly aggrieved if a transaction or operation were entered into which prevented income from accruing to the taxpayer while leaving him in the position of one to whom the income would normally and naturally accrue. The section is not, in my opinion designed to implement the expectations, however reasonable, of the Commissioner that there will be no change in

the taxpayer's affairs which will result in him getting less income; it is designed to meet the Commissioner's objections to the creation of | abnormal or unnatural situations, to the detriment of the <u>fiscus</u>."

The precursor of sec 103(2) was introduced by way of amendment (by s 90(1)(b)) to the Income Tax Act 31 of 1941 by the Income Tax Act 55 of 1946. It has since been the subject of a number of textual alterations, none presently material. It should, however, be pointed out that the 1946 provision, like s 103(2), applied to any agreement entered into "at any time before or after the commencement of the Income Tax Act, 1946". This meant, at the time, that the Commissioner was entitled to apply, say during 1947, this provision in relation to an agreement entered into during 1945. The 1962 Act came into operation on 1 July 1962 and on the plain wording of the section, the Commissioner was entitled to apply s 103(2) thereafter to an agreement entered into before that date. That being so, it is difficult to understand why, by way of extension, he was not entitled to apply it during 1986 in respect of an agreement entered into during the preceding tax year. Furthermore, the quoted phrase contains a tautology because the words "at any time" encompass the balance of it. The use of a tautology is a device often used in order to emphasise a point.

The intention to cast the net as wide as possible can also be perceived if regard is had to the use of the introductory "whenever". Its ordinary meanings are: "1. At whatever time; on whatever occasion. 2. Every time that" (SOED sv "whenever"). And according to the OED (2nd ed) its meaning in a conditional clause is "at whatever time, no matter when". To paraphrase, the sub-section states that at whatever time the Commissioner is satisfied that any agreement has at any time been effected, he may disallow the attempted set-off. The provision is replete with the indefinite "any". It appears 13 times. And as Nicholas AJA pointed out in Commissioner for inland Revenue v Ocean Manufacturing Ltd 1990 (3) SA 610 (A) 618H-619B, there is nothing in the provision to suggest that the word "any" was used in a limited sense. If regard is had to the wording of the tax avoidance provision contained in ss (1), it similarly contains no limitation as to time. By contrast, there is a provision such as s 79 which places strict time limits upon the Commissioner's power to raise additional assessments. Ss (2) also does not state that the failure of the Commissioner to have applied its provisions in the year of the agreement, prevents him from doing so in any future year. And counsel for the appellant agreed that his submission that it can only be applied in the year of the agreement is too wide because once applied, it can also be used against the taxpayer in the succeeding years.

S 20 of the Act deals with the set-off of assessed losses. It provided at the time:

> "(1) For the purpose of determining the taxable income derived by any person from carrying on any trade in the Republic, there shall be set off against the income so derived by such person -
>
> (a) any balance of assessed loss incurred by the taxpayer in any previous year which has been carried forward from the preceding year of assessment ...
>
> (2) For the purpose of this section 'assessed loss' means any amount, as established to the satisfaction of the Commissioner, by which the deductions admissible under sections eleven to nineteen, inclusive, ... exceeded the income in respect of which they are so admissible ..."

(This section has since the tax years under discussion been amended but those amendments are not material to this case.)

The application of s 20 arises as follows in the context of the Act. The charging section is s 5 and it provides (as far as is relevant for present purposes) in ss (l)(d) that an income tax is annually payable in respect of the taxable income received by or accrued to or in favour of a company during every financial year of that company. As counsel for the appellant was at pains to point out, it is one tax payable on one synthesized income. "Taxable income" is defined in s 1 as the amount remaining after deducting from the income of the company all the amounts allowed under Part 1 of Chapter 2 of the Act "to be deducted from or set off against such income". "Income" is defined as the amount remaining of the gross income of a company after deducting from it any amounts exempt from normal tax under the same part. And "gross income" is the total amount received by or accrued to or in favour of a company during any tax year.

This means that from an accounting point of view the taxable income of a company is calculated by taking a number of steps in a predetermined sequence. The gross income is first established. From it the amounts exempted are deducted in order to determine the "income" as defined. Thereafter the allowable deductions are deducted. They are, in general terms, expenditure and losses incurred in the production of income (see generally s 11), marketing allowances (s 11 bis), the cost of certain fixed assets and improvements used in the production of income (s 12B to s 14 bis), certain mining expenditures (s 15), certain expenses incurred by professional persons (s 16 and s 16A), expenses incurred in appointing agents outside the Republic (s 17), soil erosion expenditures incurred by a lessor (s 17A), medical and dental expenses (s 18), certain donations (s 18A) and sponsorship allowances.

(S 19 which then follows is, in this context, not of any moment.) Adjustments are then made by adding or eliminating items required or permitted by the Act.

If, at this juncture, there is a loss, the Commissioner has to issue an assessment of the loss "ranking for set-off" (s 1 sv "assessment"). This loss is then carried forward to the succeeding year. On the other hand, if an assessed loss has been brought forward from the preceding year, it is set off against the profit (if any) thus far calculated. As indicated above, that is also how the accountants and auditors of the appellant have prepared their tax calculation. It follows in my view from this analysis that the word "income" as used in the introductory part of s 20(1) is not used in its defined sense (cf Commissioner for Inland Revenue v Simpson 1949 (4) SA 678(A) 692) but rather as the income taxable but for the set-off. This all simply means that a set-off in terms of s 20 can only arise if there would otherwise have been taxable income i e pre-tax profit. I find it impossible to perceive how in an assessment to tax, set-off of an assessed loss can operate in relation to say an individual item of income such as the recoupment on the sale of an asset.

Returning then to s 103(2), it empowers the Commissioner to disallow the attempted set-off against "any such income" i e "income [that] has been received by or has accrued to that company during any year of assessment". It permits him no more. It does not allow him to issue a declaratory order. He has to await an attempted set-off by the taxpayer in terms of s 20. I have shown that the appellant did not claim the benefit of s 20 in 1985. He did so for the first time in 1986. There was consequently no occasion for the Commissioner to disallow the set-off of any assessed loss or balance of assessed loss during the former year. In addition the appellant had no otherwise taxable income during 1985 against which the assessed loss could have been set off. To hold that, because the Commissioner could not have applied s 103(2) to the 1985 year, entails that he could also not have done it in relation to 1986, would be destructive of the purpose of the provision. It would also allow for the evasion of the provision. It must, from a commercial point of view, be simple to structure a deal in such a manner that the change in shareholding is effected in year 1 and to have the company receive income as a result of it in year 2 or 3 whilst the assessed loss is kept alive by some or other insignificant untainted trade.

In the ordinary course of events, the failure of the Commissioner to apply s 103(2) in any particular year will be to the benefit of the taxpayer: the set-off is then "allowed" for that year. Counsel postulated a case (dealt with in some detail in the judgment of E M Grosskopf JA) where the failure of the Commissioner to apply the provision immediately could lead to the disallowance of a set-off of a loss suffered on untainted income. I find the postulate to fall within the realm of the unlikely and in any event those are not the facts of this case. In such case the taxpayer's remedy may be to have the earlier assessments reviewed; or it is possible that, in spite of the synthesis of income and taxation, that more than one assessment has to issue in relation to the year of application. If the Commissioner can unscramble the taxable income of a company that carries on mining operations as well as other trades (see Divaris & Stein, op cit, § 8.127) he ought to be able to unscramble this omelette.

If it is assumed for purposes of argument that the appellant had received income as a result of the transaction in 1985 and that in some way or other s

20 operated, I still fail to see what prejudice the appellant suffered as a result of the Commissioner's inaction. It cannot be said that the result of the application of ss (2) amounted to an additional tax or penalty. The appellant is still entitled to apply set-off of the assessed loss against untainted income.

To sum up: I am of the view that the Special Court was correct in finding that it was competent for the Commissioner to apply s 103(2) for the first time in respect of the 1986 year.

It was also argued that the Commissioner erred in his application of the sub-section by disallowing the set-off against the balance of assessed loss as at the end of the financial year in which the tainted transaction took place, namely 1985. It was submitted that the assessed loss of 1984 was the one that had to be taken into account because the section requires an intention to utilise an "assessed loss incurred", and not one to be incurred. Once again, that question is not an issue in the appeal and the request for a decision on it must be declined. The same applies to the argument that the 1985 assessment was final and not subject to a reopening.

In conclusion it is necessary to comment on the manner in which this appeal was conducted. The Chief Justice, as he was entitled to do by virtue of AD Rule 8(1), called for the filing of heads well in advance of the hearing of the appeal. The parties complied. By that stage counsel should have been prepared to argue all the issues in the appeal. That this may not have been the case is suggested by the manner in which on each side supplementary heads proliferated thereafter. Two days before the hearing the appellant filed its first supplementary heads. They had been prepared by counsel who had represented the appellant in the Special Court and eventually appeared on its behalf in this Court. (The original heads were prepared by another counsel.) The main thrust of counsel's oral argument appeared insufficiently from either set of heads. This resulted in the argument lasting much longer than would otherwise have been the case. At the end of the day the appellant's counsel was requested to file a second supplementary set of heads, incorporating his revised argument. This was duly done. Counsel for the respondent likewise produced a succession of heads: five days before the hearing supplementary heads were filed; and two further sets on the day of the hearing. In response to the appellant's third set the respondent had to file a fifth set.

In the result an appeal set down for one day, and which merited no more than one day's argument, occupied two full days. The object of the rule was stultified and the members of the Court were hampered in their preparation of the appeal. In the normal course of events all the issues involved in an appeal should be sufficiently and finally dealt with therein.

The appeal is dismissed with costs, including the costs consequent upon the employment of two counsel.

L T C HARMS
JUDGE OF APPEAL

NESTADT JA)
CONCUR
OLIVIER AJA)

JUDGMENT E

M GROSSKOPF. JA

The background to this appeal is set out in the judgment of Harms JA and it is not necessary to repeat it herein. For present purposes only the following facts are relevant.

1. At the end of the 1984 year of assessment the appellant had a balance of assessed loss of roughly R5,9 million.

2. During the 1985 year of assessment the appellant entered into an agreement which, we assume for the purposes of argument, fell within the provisions of sec 103(2) of the Income Tax Act.

3. At the end of the 1985 tax year, the assessed loss had grown to roughly R9,9 million.

4. During 1986 the appellant had a taxable income of roughly R6,7 million. At the end of that year the appellant set off against this income the assessed loss of R9,9 million.

5. During 1988 the Commissioner sought to apply sec 103(2) to the

The figures mentioned are the final ones accepted by the Commissioner. Nothing turns on their correctness or otherwise.

assessment for 1986, i c, he disallowed the set-off of income earned or accrued during that year against the assessed loss brought forward from 1985.

The issue to be dealt with in this appeal is whether the following proposition is correct:

> "The Commissioner should have applied the provisions of section 103(2) of the Act in the assessment that he raised for the year in which the agreement was entered into and in which it took effect, namely the year ended 30 June 1985.
>
> Once the Commissioner had failed to apply the provisions of section 103(2) in respect of the 1985 year of assessment, it was not competent for him to endeavour to apply the provisions of the sub-section for the first time in respect of the 1986 year, as he purported to do in the revised assessment."

The appellant's main argument in support of this proposition is that the remedy granted to the Commissioner by sec 103(2) is intrinsically incapable of being applied in respect of any tax year other than that in which the agreement is entered into and in which it takes effect. This

On the facts of the present case the agreement Took effect in the year in which it was entered into. 1: is consequently not necessary to consider what the position would be if an agreement is entered into in one year but is to take effect only in a subsequent year.

follows, so it is contended, from the very nature of the remedy. To assess the validity of this argument it is necessary to determine the exact ambit of sec 103(2). The appropriate point of departure in this enquiry is the wording of the section. It reads as follows[3].

> "Whenever the Commissioner is satisfied that any agreement affecting any company or any change in the shareholding of any company as a direct or indirect result of which income has been received by or accrued to that company during any year of assessment, has at any time before or after the commencement of the Income Tax Act, 1946, been entered into or effected by any person solely or mainly for the purpose of utilizing any assessed loss or any balance of assessed loss incurred by the company, in order to avoid liability on the part of that company or any other person for the payment of any tax, duty or levy on income, or to reduce the amount thereof, the set-off of any such assessed loss or balance of assessed loss against any such income shall be disallowed."

This section deals with the effect which may be given for tax purposes to an agreement affecting any company or any change in the shareholding of any company. For convenience I shall refer to such an arrangement as a relevant agreement. For the section to be invoked the relevant agreement must be attended by two features:

I quote it as it was prior to the amendment introduced by Act 121 of 1984 which has no bearing on the present issue.

1. As a direct or indirect result of the relevant agreement income must have been received by or accrued to the company during any year of assessment; and

2. The Commissioner must be satisfied that the relevant agreement was entered into or effected solely or mainly for the purpose of utilizing any assessed loss or any balance of assessed loss incurred by the company in order to avoid liability for the payment of any tax.

Where these features co-exist, the set-off of "any such assessed loss or balance of assessed loss" (i c, one mentioned in para 2) against "any such income" (i e, income of the sort mentioned in para 1) shall be disallowed.

Of particular importance for present purposes is the nature of the assessed losses covered by the section. In passing I should state that nothing turns on any distinction which there may be between an assessed loss and a balance of assessed loss. For the sake of brevity I shall accordingly henceforth refer only to assessed losses. What is disallowed by sec 103(2) is the set-off of any "such" assessed loss, which, as I have said, means, in the context, the assessed loss for whose utilization the tax-avoiding agreement was entered into. Thus, where a relevant agreement has, in the view of the Commissioner, been entered into for the purpose of utilizing an assessed loss for tax avoidance, it is <u>that</u> assessed loss whose set-off against income is to be disallowed.

The essential proposition for this part of the argument is that the disallowance of set-off is restricted to the particular assessed loss contemplated by the relevant agreement. If this proposition is correct it would follow that the disallowance could only arise in the year in which the relevant agreement is entered into and takes effect. This result flows from the very nature of an assessed loss. It may be best explained by examining the results of a hypothetical company during three years of assessment. In year 1 the company trades at a loss. Its loss is assessed at the end of the year at, say, R50000. This assessed loss is carried forward to year 2.

During year 2 the company enters into a relevant agreement. For sec

103(2) to be invoked, the Commissioner must be satisfied that the relevant agreement was entered into for the purpose of utilizing, for tax avoidance, "any assessed loss ... incurred by the company". The only assessed loss incurred by the company at the time when the agreement is entered into, is the loss of R50000 incurred in year 1 and assessed at the end of that year. It is to that assessed loss to which the relevant agreement must relate (to the satisfaction of the Commissioner) before the section may be applied. And it is the set-off of that loss which will be disallowed in terms of the section.

A particular assessed loss has a notional existence for only a single year of assessment. The carrying forward of assessed losses is authorized by sec 20(l)(a) of the Act, which, in so far as it is relevant, reads -

> "For the purpose of determining the taxable income derived by any person from carrying on any trade within the Republic, there shall be set off against the income so derived by such person -
>
> > (a) any balance of assessed loss incurred by the taxpayer in any previous year which has been carried forward from the preceding year of assessment..." (emphasis added).

This provision, and, in particular, the italicized part,

"... envisages a continuity in setting off an assessed loss in every year succeeding the year in which it was originally incurred, so that in each succeeding year a balance can be struck to the satisfaction of

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the Secretary which can then be carried forward from year to year until it is exhausted; if, for any reason, the assessed loss cannot be so set off and balanced in any particular year, there is then no 'balance of assessed loss' for that year which (viewed from that year of assessment) can be carried forward to the succeeding year, or (viewed from the succeeding year of assessment) there is no 'balance of assessed loss which has been carried forward from the preceding year of assessment'; in other words, the essential continuity has been fatally interrupted." (New Urban Properties Ltd v Secretary for Inland Revenue 1966 (1)SA 217 (A)at 224 E-F).

Inland Revenue 1966 (1) SA 217 (A) at 224 E-F).

It is clear therefore that at the end of each year of assessment a new balance is struck reflecting the effect of that year's trading on the balance of assessed loss brought forward from the preceding year. In our hypothetical example above, the loss assessed at the end of year 1 exists only during year 2. At the end of year 2 it is replaced by a new figure being either a profit or a loss. If at the end of year 2 the company still has an assessed loss, it is a different assessed loss from that with which it started the year. The assessed loss at the end of year 2 represents a balance between different items from those which made up the assessed loss in year 1.

From what I have said above, the following propositions emerge:

1. A relevant agreement is struck by sec 103(2) if it contemplates the utilization for tax avoidance of an "assessed loss ... incurred by the company". This can only mean an assessed loss existing at the time of the conclusion and taking effect of the agreement.

2. The effect of sec 103(2) is to disallow the setoff of "such assessed loss", i e, the assessed loss contemplated by the relevant agreement.

3. The assessed loss has an effective existence for only one year. It is only during that year that its set-off can be either permitted or disallowed.

4. It follows that sec 103(2) can be applied only to the assessed loss existing in the year in which the relevant agreement is concluded and takes effect.

Applied to the facts of the present case, this line of reasoning leads to the result that the Commissioner could have applied sec 103(2) only to the appellant's 1985 year of assessment. In respect of that year the Commissioner was entitled (assuming that all other requirements of the section had been satisfied) to disallow the set-off of the assessed loss of R5,9 million, which had been brought forward from the 1984 year of assessment, against income earned or accrued during the 1985 tax year as a result of the relevant agreement (i e, against tainted income). In any subsequent year the relevant assessed loss (i e, the assessed loss which formed the raison d'être of the relevant agreement) no longer existed. Its set-off could no longer be permitted or disallowed. Nor could the section be applied to a new assessed loss arising from a fresh balance struck at the end of the 1985 year of assessment for utilization during the 1986 year of assessment.

As I have said, this reasoning formed the basis of the appellant's argument before us. Respondent's counsel provided no answer to it. It is not dealt with in the judgment of Harms JA.

I turn now to possible objections to this line of reasoning. The basis of the reasoning is that the words "any assessed loss ... incurred by the company" should receive its ordinary grammatical meaning. To justify the Commissioner's attitude a departure from the ordinary meaning of the words is required. They should then be read as covering not only an assessed loss already incurred but also losses expected to be incurred and assessed in the future. What justification is there for such extensive interpretation?

Much attention was given in argument to the question whether there was any tainted income[4] in the appellant's 1985 year of assessment against which the assessed loss in that year could have been set off. The factual position by itself is, of course, irrelevant for present purposes. If sec 103(2) could in principle have been applied only in the 1985 year of assessment, and in that year there was no tainted income, then sec 103(2) was simply inapplicable. The factual circumstances would not justify the application of the section in a subsequent year in a manner not permitted by the legislation. However, the scope of the set-off authorized by sec 20 of the Act (and, in defined circumstances, disallowed by sec 103(2)) is of great importance in itself, and may cast some light on the presumed intention of the lawgiver in enacting sec 103(2). I therefore propose dealing with it, particularly since I respectfully disagree with what Harms JA has written in this regard.

i e. income received by or accrued to the appellant as a direct or indirect result of the relevant agreement.

2 Sec 20 allows the set-off of an assessed loss against "income". "Income" is defined in sec 1 as "the amount remaining of the gross income ... after deducting therefrom any amounts exempt from normal tax under Part I of Chapter II". "Income" is then further reduced to establish "taxable income". This step entails the deduction from "income" of "all the amounts allowed under Part I of Chapter II to be deducted from or set off against such income." Section 20 is the only section which provides for a set-off against income.

The position thus is that "taxable income" is made up of "income" less deductions (mainly of costs and expenses) and less the set-off of assessed losses. There is nothing in the Act to indicate that the set-off can operate only after the deductions have been made, and only if there then remains a profit, as suggested by Harms JA. The mere fact that the provisions regarding deductions appear in sections of the Act before sec 20 cannot lead to this result. Nor can the fact, if fact it be, that in accounting practice the matter is dealt with in this sequence. But in my view it is the practical result of the view expressed by Harms JA which, with respect, demonstrates its untenability. Let us again take a hypothetical example. At the end of year 1 a company has an assessed loss of R50 000. During year 2 it earns income of R20 000 and incurs deductible expenditure of R30 000. On the construction favoured by Harms JA the first step in calculating "taxable income" in year 2 would be to deduct the expenditure of R30 000 from the income of R20 000. This leaves a net deficit of R10 000. Because there is not a trading profit, he suggests, sec 20 cannot be invoked. The assessed loss at the end of the year would accordingly be R10 000. The R50 000 brought forward from year 1 cannot be utilized in year 2, and, because of the principle applied in the New Urban Properties case (supra), can never be utilized again. Nor, I take it, can the taxpayer set off (in terms of sec 20 (l)(b)) an assessed loss incurred during the same year of assessment in carrying on another trade. This result would be so inconsistent with the scheme of the Act that it would require clear language to achieve it. In my view both the language of the Act, and the clear policy underlying it, lead to

4 a different conclusion. In the hypothetical case considered above the true position in my view is as follows. There is, in year 2, one credit item and two debit items. The credit item is the income of R20 000. The debit items are the expenditure of R30 000 and the assessed loss of R50 000 brought forward from the preceding year. These must both be brought into account and a balance struck between the credit item and the debit items. The result is a new assessed loss of R60 000. As far as I know, this is also the manner in which sec 20(l)(a) and its predecessors have been consistently applied in the past.

It follows that "income" in sec 20 bears its ordinary meaning as defined in sec 1. Sec. 20 does not require for its application that the taxpayer must have made a profit during the relevant year of assessment. Indeed, there is a school of thought that sec 20 may be applied even where no income was earned during the relevant year of assessment, provided only that the taxpayer carried on a trade. Cf I T C 644 (1948) 16 SATC 125; IT C 777 (1953) 19 SATC 320 at 322; S A Bazaars (Pty) Ltd v Commissioner for Inland Revenue 1952 (4) SA 505 (A) at 511a; Divans & Stein, Silke South African Income Tax, para 8.127; 8.127; Meyerowitz and Spiro on Income

Tax, para 856. It is not necessary for me to pronounce on this point. For present purposes it is sufficient to emphasize that the set-off, of an assessed loss against income under sec 20(l)(a), is permitted even if the taxpayer did not make a trading profit during the year of assessment in question.

This discussion of the ambit of sec 20(l)(a) was to some extent a digression although, as will be seen, it is not entirely irrelevant. The question for decision remains: what is meant by the words "assessed loss ... incurred by the company" in sec 103 (2) of the Act?

A number of arguments were advanced in favour of a wider interpretation than the words would appear to bear in their ordinary meaning. Firstly, it was suggested that the section would be easy to circumvent if the natural meaning of the words were to be applied. This argument ties in to some extent with the meaning of "income" in sec 20(l)(a) and in sec 103(2). The scheme of the Act is that sec 20(l)(a) permits, in general, the set-off of an assessed loss against income. However, such set-off is disallowed in certain circumstances by virtue of sec 103(2). The two sections are thus complementary, and there is no reason in my view why the word "income" should not bear the same meaning in both sections, and no reason why that meaning should not be the defined meaning.

To circumvent sec 103(2), as suggested in argument, a company would therefore have to enter into a relevant agreement which does not give rise to any tainted income during the year in which the agreement was entered into and took effect. And in this regard I must emphasize again that I am talking about income in the technical sense, and not to profit. Even in the present case, where the agreement was entered into on the last day of the year, there was, in the view of the Special Court, tainted "income", in the technical sense, during that year. And, although Harms JA doubts the correctness of this finding, his strictures are based mainly on matters of onus and lack of evidence. I have little doubt that, if the Commissioner had wanted to apply sec 103(2) to the appellant's 1985 year of assessment, a

7 proper investigation would have established the existence of tainted income during that year. On the whole I find it difficult to envisage easy ways of circumventing the section.

Of course I would not wish to underrate the ingenuity of businessmen. No doubt schemes could and would be designed to circumvent the provisions of sec 103(2). One must, however, bear in mind that sec 103(2) is not the only, or even the main, provision to combat tax avoidance. The principal one is section 103(1). A relevant agreement which is deliberately structured in such a way that it takes effect in year 1, but gives rise to no income at all in that year, would, I imagine, be an easy target for the invocation of sec 103(1).

Then reliance was placed on the legislative history of sec 103(2). Its origin is to be found in sec 90(l)(b) of the Income Tax Act, No 31 of 1941, which was introduced by sec 20(1) of the Income Tax Act No 55 of 1946. This section referred to an agreement which had "at any time before or after the commencement of the Income Tax Act, 1946, been entered into or effected by any person ...". The 1946 Act was promulgated on 21 June 1946. At that stage the greater part of the 1946 year of assessment (terminating on 30 June 1946) had elapsed. The reference to agreements before the commencement of the Act could be applied to the part of the current tax year which had already elapsed. It accordingly affords no reason to suppose that the substantive provisions of the precursor to sec 103(2) were not to be interpreted in accordance with their normal meaning. And the repetition of the reference to the commencement of the 1946 Act in the consolidation act of 1962 has in my view as little significance as that traditionally accorded to the continued existence of the vermiform appendix in the human anatomy.

Much was made in argument and by the court a quo of the wide language used in section 103(2), and, in particular, of the repetition of the word "any". Clearly the legislature wanted the section to be applied to all cases falling within its ambit. However, in determining its ambit one must have regard to its substantive provisions. If at any one time there can be only one "assessed loss... incurred by the company" the use of the word "any", however repetitively, cannot alter this situation. Reliance was also placed on the word "whenever" with which the section commences. "Whenever" is defined in The Shorter Oxford Dictionary as, infer alia, "in any or every case in which". In this sense (which is very common in legislation, and also in other provisions of the Income Tax Act - see e g secs 37(1), 103(4) and 104(2)) the word has no connotation of time and is entirely consistent with the ordinary meaning of sec 103(2).

In short, I disagree with the various contentions which have been advanced to support a result which is at variance with the normal meaning of sec 103(2).

Mr Broomberg, who appeared for the appellant, submitted that in fact the normal meaning of the words led to a much more practical end equitable result than would that contended for by the Commissioner. On the appellant's construction the section would be applied in the year in which the relevant agreement was entered into and took effect. The set-off of the assessed loss would accordingly be disallowed during that year. This would sterilize the assessed loss - it could not be further used in future years*. In argument it was accepted that this sterilization would apply only in respect of the tainted income. In other words, the assessed loss could be carried forward for the limited purpose of set-off against untainted income. For the sake of the present argument I assume (since it is not important, as I shall show) that this view is correct and that the sterilization of the assessed loss is not complete, a matter which is not free from doubt (see Meyerowitz and Spiro, supra, para 855). On that basis one must then compare the practical working of sec 103(2) in accordance with the contentions respectively advanced by the parties.

I imagine that it would often be difficult to distinguish between tainted and untainted income, particularly after the passage of time. This difficulty would be increased if an assessed loss in some future year were to be subject to sec 103(2). Fairness would then require that separate assessments would have to be made not only of tainted and untainted

This does not mean that sec 103(2) is again used in succeeding years as suggested by Harms JA. The sterilization of the assessed loss flows from [he provisions of sec 20(l)(a), as I have shows above.

income, but also of the expenditure incurred in producing each of them. And, in order to apportion the assessed loss accurately, the relevant calculations would have to be taken back from the date when sec 103(2) is applied to the date of the relevant agreement. On the respondent's argument this could be a substantial number of years. Even if legislative sanction existed for such a procedure (a matter which I do not propose deciding) this would often be an almost impossible task. It seems to me, therefore, that Mr Broomberg is right in contending that the interpretation which he espouses leads to a simpler and more equitable result than the rival interpretation advanced by the respondent. Of course, the result would be even simpler, but probably less equitable, if the application of sec 103(2) led to the complete sterilization of the assessed loss, even for future use against untainted income. Whether this is so or not does not, however, materially affect the argument one way or the other and, as I have indicated above, and I do not propose deciding it.

To sum up, I consider that no good grounds have been advanced for not according the language of sec 103(2) its ordinary meaning. It follows that in my view the Commissioner was entitled to apply the section only in respect of the appellant's 1985 year of assessment and his purported application thereof during the 1986 year cannot stand. Whether the Commissioner can still reopen the assessment for the 1985 year so as to apply sec 103(2) is a matter which was debated before us but does not, I consider, fall to be decided in this appeal.

Mr Henning, who appeared for the Commissioner, raised a number of arguments extraneous to the interpretation of sec 103(2) in support of the dismissal of the appeal. Since this is a minority judgment I do not propose dealing with them. In my view they are all without substance.

I consider that the appeal should be allowed.

E M GROSSKOPF, JA

HOEXTER, JA Concur