IN THE SUPREME COURT OF SOUTH AFRICA

(APPELLATE DIVISION)

CASE NO. 312/93

SENTRA-OES KOöPERATIEF BPK

APPELLANT

VERSUS

KOMMISSARIS VAN BINNELANDSE INKOMSTE RESPONDENT

CORAM: CORBETT CJ, HOEXTER, SMALBERGER,
KUMLEBEN JJA et NICHOLAS AJA

DATE HEARD: 17 NOVEMBER 1994

DATE DELIVERED: 9 MARCH 1995

NICHOLAS AJA

J U D G M E N T

NICHOLAS AJA:

The question for decision in this appeal is whether a deduction of R5 million claimed in the 1988 tax year by Sentra-oes Koöperatief Beperk ("the company") and disallowed by the Commissioner for Inland Revenue ("the Commissioner") is allowable in terms of the Income Tax Act 58 of 1962 ("the Act").

The company is a short-term insurer, offering co-operative crop insurance to the members of its member co-operatives. Most of its business - about 98% - consists in the insurance of crops against damage by hail. Its premium income is received throughout the year with peaks

usually in the months between September and February. Claims arise mainly in the rainy season and in general mostly in the months of November to February.

When hail damage occurs the insured is required to report that fact within three days. The company has agricultural experts throughout the country one of whom visits the farm concerned as soon as possible after the report and assesses the extent of the damage as a percentage of the insured crop. When this has been agreed with the insured, the assessment is sent to the head office of the company and processed there. A cheque is dispatched within three weeks at most, but usually within a matter of days.

In order to ensure that it will always have funds available to pay

claims as they arise, the company invests its premium income in short-term deposits, either on daily call or for fixed periods of three or four months and occasionally even longer. Its practice is to invite selected banks and recognized financial institutions to make written quotations for specific amounts as moneys for deposit become available, and then to make investments according to a definite plan and a cash-flow budget which provide for a worst-case scenario in order that it can always comply fully and expeditiously with the claims made upon it. The aim is to obtain the best income possible and to provide an adequate spread of investments to reduce risk and provide the required cash flow.

Details of the company's short-term investments as at 7 December 1988 which totalled R 56,5 million appear from the schedule which is

annexed to this judgment.

In March 1988 a representative of Mr W H Vermaas, a well known attorney and businessman in Pretoria, approached the company and solicited investments in Reef Acceptance (Pty) Ltd, one of Vermaas's companies. He spoke of Vermaas's influential connections in high places. He said that favourable interest rates were available and offered other inducements. The company obtained a bank report from Volkskas, which was to the effect that it regarded "Reef Acceptance (Pty) Ltd/Mnr W H Vermaas" as good for an amount of R10 million. Between 28 March 1988 and 3 November 1988 the company made five deposits with Reef Acceptance. They were of amounts varying from R2 million to R5 million, for periods of between 1 month and 3 months, and at rates of

interest varying between 12% and 19.55% per annum. All were duly repaid with the exception of the deposit of R5 million which was repayable on 3 December 1988. (See the second item in the annexe.) When it became clear to the company that this amount would not be repaid, it placed Reef Acceptance in liquidation. The amount became irrecoverable.

In its return of income for the year ended 31 December 1988 the company claimed as a deduction the sum of R5 million in terms of s 11(a) and s 28(2)(c) of the Act. The Commissioner disallowed the deduction and issued an assessment in respect of a taxable income of R 1 314 754,00. The company's objection to the assessment was disallowed and it appealed. The appeal was heard at a sitting of the

Cape Income Tax Special Court at which Berman J presided. S

11(a) and s 28(2) of the Act provide -

"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". "28 (2) Subject to the provisions of this Act the taxable income derived by any taxpayer from the carrying on in the Republic of short-term insurance business (whether on mutual principles or otherwise) shall be determined by charging against the sum of all premiums (including premiums on reinsurance) received by or accrued to such taxpayer in respect of

the insurance of any risk, and other amounts derived from the carrying on of such business of insurance in the Republic, the sum of -

(1) the total amount of the liability incurred in respect of premiums on reinsurance;

(2) the actual amount of the liability incurred in respect of any claims during the year of assessment in respect of that business of insurance, less the value of any claims recovered or recoverable under any contract of insurance, guarantee, security or indemnity;

(3) the expenditure, not being expenditure falling under paragraph (a) or (b), incurred in respect of that business of insurance;

(4) ...;

(5) ...; and

(f) ..."

In the judgment of the special court Berman J said that the Act drew a distinction between "expenditure" and "losses"; that the amount of R5 million in issue was lost by the company, not expended by it; and that s 28(2)(c) related only to expenditure and not to losses. It followed that the appeal failed on this simple ground.

However, Berman J went on to consider whether the loss was deductible in terms of s 11(a). He said that in order to succeed the company had to show two things: (1) that the loss of R5 million was incurred "in the production of the income" and (2) that the loss was not of a capital nature. He concluded that the loss of R5 million was a loss of a capital nature and hence did not qualify as a deduction. The appeal was accordingly dismissed. The company now appeals to this court.

The company applied in limine for condonation of its failure to timeously file its power of attorney and the supporting resolution thereto. The Commissioner opposed the grant of condonation, but only on the ground that there were no reasonable prospects of success on appeal. The court accordingly deferred its decision on the application for condonation until it had heard the argument on the merits.

It was submitted on behalf of the Commissioner that s 11(a) designedly uses the expression "expenditure and losses" whereas s 28(2)(c) refers only to "expenditure"; that s 11(a) is concerned with the determination of the taxable income derived by persons generally, whereas s 28(2) is concerned with the determination of the taxable income derived by short-term insurers; and that on the principle

embodied in the maxim generalia specialibus non derogant. if a deduction was claimable by a short-term insurer, it was claimable only under s

28(2)(c).

The question whether there is a real distinction between "expenditure" and "losses" for the purpose of s 11(a) and, if so, what the distinction is, has been discussed by this court in a number of cases. See Stone v Secretary for Inland Revenue 1974(3) SA 584(A) at 593 H - 594 G and cases there cited; and Solaglass Finance Co (Pty) Ltd v CIR 1991(2) SA 257(A) at 279 B - H. In CIR v Felix Schuh(SA)(Ptv) Ltd 1994(2) SA 801(A) it was said at 812 A that broadly speaking, as the cases show, "expenditure" refers to disbursements or expenses incurred or paid voluntarily, whereas "losses" connote involuntary deprivations

occurring fortuitously. The amount of R5 million invested in Reef Acceptance was not expenditure but a loss, in the sense of an involuntary deprivation.

The question then is, whether the effect of s 28(2)(c) is to confine the deduction available to a short-term insurer to "expenditure" and to exclude a loss. In this connection the opening words of ss(2) of s 28, "Subject to the provisions of this Act", are important. They are to be contrasted with the opening words of ss(l), "Notwithstanding anything to the contrary contained in this Act". In the majority judgment in S v Marwane 1982(3) SA 717(A) at 747H-748B, Miller JA explained that the purpose of the phrase "subject to" when used in a legislative provision, is -

". . . to establish what is dominant and what subordinate or subservient; that to which a provision is 'subject', is dominant - in case of conflict it prevails over that which is subject to it. Certainly, in the Geld of ! legislation, the phrase has this clear and accepted ! connotation. When the legislator wishes to convey that that which is now being enacted is not to prevail in circumstances where it conflicts, or is inconsistent or incompatible, with a specified other enactment, it very frequently, if not almost invariably, qualifies such enactment by the method of declaring it to be 'subject to' the other specified one. As MEGARRY J observed in C and J Clark v Inland Revenue Commissioners (1973) 2 All ER 513 at 520:

> 'In my judgment, the phrase 'subject to' is a simple provision which merely subjects the provisions of the subject subsections to the provisions of the master subsections. When there is no clash, the

> phrase does nothing: if there is collision, the phrase shows what is to prevail.' But when the intention is that that which is now being enacted shall prevail over other laws or provisions which may be in conflict with it, it is almost invariably prefaced by a phrase such as 'notwithstanding any contrary provision . . .' or words to similar effect. . . "

The effect of the words, "subject to the provisions of this Act", is therefore that if there is a conflict, inconsistency or incompatibility between them, the general deduction formula contained in s 11(a) prevails over the specific provision in s 28(2)(c). And no reason suggests itself why the legislature should have wished to exclude the application to a short-term insurer of the deduction formula which in terms of s 11(a) is applicable to any person carrying on any trade within

the Republic.

The enquiry then is whether the loss was one "not of a capital nature".

It was submitted on behalf of the company that the amounts received by way of premiums were income in its hands. They were not treated as part of its general funds but were in effect sequestered in a separate fund for the purpose of meeting claims. Consequently they were not capital, either in the sense of fixed capital or in the sense of circulating or floating capital.

It is the fact that the premiums when received were revenue. But having been received they were used by the company in order to produce income by way of interest and hence functioned as capital. "[Gross

income] . . . results from work and labour or the use of capital in productive enterprise or the loan of capital. . ." (Port Elizabeth Electric Tramway Co v CIR 1936 CPD 241 at 243). So, when money is lent at interest it is either fixed capital or circulating capital.

The evidence of Dr van Rooyen, the general manager and chief executive officer of the company, was that the essence of its business was to receive from a large pool of insured persons, premium income which would be available to satisfy claims in respect of crop damage. Instead of placing that money in a box, the company made investments in short-term deposits at the best possible rate of interest. The short-term investment of funds surplus to its immediate requirements was a limb of its insurance business. It was a part, and an important part, of that

business. (In the 1988 tax year there was a profit of about R10,9 million on premium account, and an interest income of about R 6 million.)

The question is, was the money which was lost fixed or floating (circulating) capital? If it was fixed capital, then the loss was of a capital nature; if floating (or circulating) capital, then it was a non-capital loss. See Stone's case at 595 A, In that case Corbett JA said at 595 G - 596 B, after discussing the distinction between revenue expenditure and capital expenditure:

> "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. It has been accepted in a number of cases, mainly in the Special Court, that where the taxpayer can show that he has been carrying on the business of banking or money-lending, then losses incurred by him as a result of loans, made in the course of his business, becoming irrecoverable are losses of a non-capital nature and deductible.. . . 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. There is, however, in my view, no warrant for extending this principle to loans by persons who are not conducting a money-lending business."

The business of a bank was described in Punjab Co-operative Bank. Ltd., Amritsar v Income Tax Commissioner, Lahore [1940] 4 All ER 87(PC) at 95 F -

> "In the ordinary case of a bank, the business consists, in its essence, of dealing with money and credit. Numerous depositors place their money with the bank, often receiving a small rate of interest on it. Numerous borrowers receive

> loans of a large part of these deposited funds at somewhat higher rates of interest, but the banker has always to keep enough cash or easily realizable securities to meet any probable demand by the depositors ..."

A money-lender is "One whose business is lending money at interest." (The Shorter Oxford English Dictionary). Both a bank and a money-lender are in the business of dealing in money as their stock-in-trade.

Whether a person is a money-lender is a question of fact. It is not enough that a person has on several occasions lent money at interest. To qualify as a money-lender it is requisite that he should be in the business of money-lending. That imports a certain degree of system and continuity about the transactions and that he is a person who is ready and willing to lend to all and sundry if they are acceptable to him. See

Secretary for Inland Revenue v Crane 1977ff) SA 761(T) at 768 C - F, which was cited with approval by Friedman AJA in the Solaglass case at 271 C-D. This was a minority judgment but in this respect the majority judgment is not at variance.

It was submitted on behalf of the company that the loss was a loss incurred in the course of its investment business and that the principles applicable to banks and to money-lenders apply equally to the company:

> "It was prepared to lend such income to any borrower it regarded as eligible and who offered an adequate return. Investment was done on a system or plan which discloses continuity in laying out and getting back the premium income for further use and involved a frequent turnover thereof. Interest earned therefrom is not insubstantial."

The first sentence is not supported by the evidence. The company

did not hold itself out as being prepared to lend money to any eligible borrower who applied for a loan. The initiative came always from the company which, when it had moneys available for deposit, would telephone the financial institutions with which it customarily dealt and request quotations in writing. The business of the company was short-term insurance, not lending money. While the income it received by way of interest was considerable, the deposits were made in the course of carrying on its insurance business, as an incidental part of it.

Reliance was placed on an Australian case (The Commissioner of Taxation v The Commercial Banking Co. of Sydney Ltd) which was cited in ITC 836 (1957) 21 SATC 330, a judgment of Faure Williamson J sitting in the Transvaal Income Tax Special Court. There Street CJ

was reported as saying -

> "It has been contended that this is a case of an ordinary realization of an investment and that the loss is a loss of capital and not a loss incurred in the production of income . . . The purchases and sales of Government Stock were made in the course of carrying on the respondent's business as a bank and it is manifest that what it did was to invest temporarily and for purposes of profit funds which it did not immediately require for other purposes but which in the course of carrying on its business it might at any time require. In order that they might not be idle it invested them temporarily until they were required for some other purpose: and in order that they might be immediately available when required it invested them in liquid securities, that is to say in Government Stock. That in my opinion is not an investment of capital within the meaning of the Act in any proper sense of the word; the money used was part of the respondent's stock-in-trade, it was used in an

> operation of business and it was used in carrying out the respondent's scheme of profit-making as a banker."

There is a strong similarity between the investment operations of the company and those described in this passage. But there is a fundamental distinction. The Commercial Bank of Sydney was a bank; the purchases and sales of Government Stock were made in the course of carrying on its business as a bank; the money used was part of its stock-in-trade; and it was used in carrying out its scheme of profit-making as a banker.

The company does not carry on the business of a bank. It does not deal with money as its stock-in-trade. Essentially its business consists in receiving premiums and meeting claims. The fact that as an

incident of its business it performs some operations of a kind performed by a bank does not mean that it is a banker or analogous to a bank.

In my opinion therefore the decision of the special court was right: the money lost was fixed capital and the loss was "of a capital nature". It is ordered that -

1. The application for condonation is refused with costs including the costs of two counsel.

2. The appeal is struck off the roll. The appellant is ordered to pay the costs of appeal, including the costs of two counsel.

H C NICHOLAS ACTING JUDGE OF APPEAL
CORBETT CJ) HOEXTER JA) CONCUR SMALBERGER JA)

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