The Republic of South Africa

THE SUPREME COURT OF APPEAL

reportable

Case no: 249/99

In the matter between

The Commissioner for Inland Revenue **Appellant**

and

SW Van der Merwe **First Respondent**
TR Franklin **Second Respondent**
JM Connolly **Third Respondent**
AH Gunn **Fourth Respondent**
DJ Rennie **Fifth Respondent**
AA Mutual Insurance Association Ltd **Sixth Respondent**

Coram: **HEFER ACJ, HARMS, CAMERON JJA, BRAND, NUGENT AJJA**

Date of Hearing: **22 February 2001**

Date Delivered: **9 March 2001**

Income Tax - part of business of insurance company liquidated under Insurance Act - levy of tax.

JUDGMENT

Hefer ACJ

HEFER ACJ

[1] Although the Insurance Act 27 of 1943 was repealed almost in its entirety by the Long Term Insurance Act 52 of 1998, its provisions still govern the events which gave rise to the litigation leading to the present appeal. The Act gave formal recognition to the custom of insurance companies to conduct business in more than one class of insurance. Indeed, it went further by prescribing that assets held by an insurer in relation to one business shall be held as a security for the payment of debts relating to that business only, and shall not be available for the payment of debts relating to any other business. It also provided for the judicial management or winding-up of the whole or any class of an insurer's business.

[2] We are concerned with a company called AA Mutual Insurance Association Limited ("AAM", the sixth respondent), a registered insurer which conducted short term as well as compulsory third party insurance business until June 1986 when an order liquidating the short term business was granted in the Transvaal Provincial Division. The first five respondents were appointed as liquidators. After their appointment the liquidators discovered that AAM had overpaid its provisional income tax in respect of the 1984 and 1985 years of assessment. The overpayment was caused by an incorrect calculation of AAM's provisional tax liability in relation to its short term business in terms of s 28(2) of the Income Tax Act 58 of 1962. Subsequent negotiations with the Receiver of Revenue led to the issue by the latter of statements of account reflecting a credit in AAM's account as at 11 December 1987

to the tune of almost R4.5m. The Receiver brought this credit into account when he assessed AAM to tax for the 1991 and 1992 tax years in relation to income which had been earned by the liquidators in respect of the short term business in liquidation. The liquidators allege, i a, that the amount in question is due to them for distribution among the creditors of the short term business. The Commissioner, on the other hand, avers that the credit has been expunged by the debits passed in respect of AAM's alleged income tax liability during 1991and 1992.

[3] The liquidators brought proceedings on notice of motion in the Transvaal Provincial Division in which they sought a series of orders. The Commissioner opposed; but the Court *a quo* (Hartzenberg J) eventually ordered him to pay to the liquidators the amount of R4 488 692.00 with interest and costs and granted them certain other relief in the form of directions and declaratory orders to the effect that the post liquidation income was not subject to tax in the hands of either the liquidators or AAM. Subsequently leave was granted to the Commissioner to appeal to this Court.

[4] The main premise of the Court *a quo*'s judgment is that the effect of the liquidation order was to create two separate entities, each with its own assets and liabilities, one being the company and the other the business in liquidation. Because, as I see it, the outcome of the appeal depends entirely on the correctness of this proposition I will deal with it immediately.

[5] The key to the problem is s 19 of the Insurance Act. The relevant parts read as follows:

> "(1)Every domestic insurer who carries on -
>
> (a) long term insurance business; and
>
> (b) any other business,
>
> shall ... determine which of his assets shall be deemed for the purposes of this Act to be held in respect of his long term insurance business, and shall thereafter treat those assets and every amount by way of income or otherwise derived therefrom and all premiums received in respect of long term insurance business as assets held in respect of long term insurance business and shall not deal with any such asset as if it were held partly in respect of that business and partly in respect of any other business ...

(2) ...
(3) The assets referred to in the preceding sub-sections shall be a security for the payment of debts relating to-

(a) the long term insurance business carried on by a domestic insurer; or

(b) ...

(4) The provisions of the preceding sub-sections shall *mutatis mutandis* apply to -

(a) every domestic insurer who carries on any short term insurance business;

(b) ...
(c) every domestic insurer who carries on compulsory third party insurance business and;
(d) ..."

[6] Sec 32(2) provides that

> "(2)[a]n order for the winding-up of the business of a domestic insurer shall extend to his whole business, or to any class of his business which is to be wound up in terms of the order ..."

[7] It is useful to bear in mind what Coetzee J said about this provision in *Lindsay Keller & Partners v AA Mutual Insurance Association Ltd and Another* 1988(2) SA 519 (W) at 523I-G *viz*:

> "When it comes to winding up a company, the Insurance Act is completely silent. There is not a single provision which refers to that. Sections 30-32 which deal with winding-up and judicial management speak only of the winding-up or judicial management of the 'business' and not of the company at all ... It is important not to confuse the 'business' of a registered insurer with the registered insurer itself. There is no warrant, linguistically, for equating the two concepts and, legally, even less - if that were possible .... In company law there is no room for separating a company and the business which it carries on. The latter is simply the asset of the former and there does not exist such a concept in company law as the winding-up of assets of a company ... It seems clear that the Insurance Act is concerned only with the winding-up of insurance business of a company in contradistinction to the winding-up of the company itself. The present case is an excellent illustration of that. The company's

> short term insurance business was wound up, leaving it well and sufficiently alive to oppose in this application its own winding-up".

[8] I respectfully agree. My understanding of the position under s 32(2) is that a winding-up order in respect of one class of business does not affect the position brought about by s 19 other than to transfer the control over and administration of certain assets to the liquidator. In other words, the reservation of assets occurs *before* liquidation as a result of the operation of s 19 and is not affected by the winding-up order other than in matters of control and administration. Effectively there are two sets of assets: the one set remains under the control and administration of the directors of the company (where the insurer in question is a company); and, as a result of the order, the other set, comprising the assets relating to the business which is being wound up, is controlled and administered by the liquidator. But both sets remain the property of the company. And the same applies to liabilities: both pre- and post-liquidation debts are the debts of the company although the debts relating to the business in liquidation have to be paid, in so far as they can be paid, by the liquidator from the funds or assets under his control and administration.

[9] This position (which, it must be stressed, has been brought about by the Insurance Act itself) cannot be changed by the court in its directions to the liquidator. Sec 32(4) provides that

> "(4)[t]he court may issue such directions to the liquidator with regard to the winding-up as it deems desirable in the circumstances of the case, *and such directions shall prevail over the provisions of any law other than this Act, which are inconsistent with such directions*."

The words which I have emphasized were plainly intended to refer to the practical way in which the winding-up of any particular business or class of business is to take place and cannot, as counsel for the liquidators conceded, be interpreted in such a way that they confer upon the court the power to override any principle of substantive law. In any event, according to the express words of the provision, the court's directions cannot nullify any provision of the Insurance Act such as s 19.

[10] It follows, therefore, that the basic premise of the judgment of the Court *a quo* cannot be supported.

[11] This conclusion has a profound effect on the second leg of the court's findings. On the supposition that the business in liquidation is a separate entity the learned judge found that such an entity is not a "person" as envisaged in the Income Tax Act and is accordingly immune from income tax in respect of income generated as from the date of liquidation. Under s 5(1) of this Act normal tax is payable in respect of the taxable income received by or accrued to or in favour of

> "(a) any person ...
>
> (b) ...
> (c)any company during every financial year of such company."

It is not necessary to decide whether the business in liquidation is a person as envisaged in s 5(1) because that question simply does not arise. We are dealing with a company. Before the winding-up order all the income of the respective businesses accrued to the company and not to its separate businesses despite the fact that the assets relating to the short term business were not available for payment of the debts of the compulsory third party business. AAM was the taxpayer (cf s 28(3) of the Income tax Act). After the order the position relating to the assets and debts remained precisely the same; as has already been shown the only difference is that the

short term business is now controlled by the liquidators. During the process of liquidation substantial income was earned through the efforts of the liquidators by employing the assets under their control. That income plainly still accrues to the company despite the fact that it was earned and is controlled by the liquidators (cf *Van Zyl NO v Commissioner for Inland Revenue* 1997 (1) SA 883 (C)). This being the case, the Commissioner rightly assessed AAM to tax in respect of the income earned by the liquidators.

[12] The liquidators' case is that, because the overpayment which gave rise to the credit was calculated in respect of income relating to the short term business, the amount of money that it represents is an asset which they are in duty bound to recover for the benefit of the creditors of that business. That misses the point. The question, at best for the liquidators, is whether this claim for repayment was, at the time of liquidation, an asset of the short term business. There is no evidence that it was. The indications are to the contrary because it was only after liquidation that either AAM and the liquidators became aware of the overpayment. The mere fact that the taxpayer, AAM, had calculated the amount it had to pay with reference to the short term business, does not mean that the overpayment was an asset of the short term business. Unless AAM had so earmarked it, it could not have become an asset of that business (see secs 19 and 23 of the Insurance Act).

[13] From this it follows that none of the Court *a quo*'s orders can stand.

The appeal is upheld with costs, including the costs of two counsel. The order of the Court *a quo* is replaced with an order dismissing the application with costs, including the costs of two counsel.

JJF HEFER

Acting
Chief Justice

Concur:

Harms JA
Cameron JA
Brand JA
Nugent JA