THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

Reportable
Case No 034/03

In the matter between

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICES **Appellant**

and

MEGS INVESTMENTS (PTY) LTD **1st Respondent**

SNKH INVESTMENTS (PTY) LTD **2nd Respondent**

Coram	Zulman JA, Brand JA, Cloete JA, Jones AJA and Ponnan AJA
Heard	17 March 2004
Delivered	31 March 2004

Summary: Income tax – Set-off of assessed loss in terms of s 20 of Act No 58 of 1962 – whether the tax-payer, a company, carried on a trade within the republic during the tax year in question.

JUDGMENT

Jones AJA

JONES AJA:

[1] In this appeal, the appellant, who is the Commissioner for the South African Revenue Services ('the Commissioner'), seeks to overturn a decision that the respondent tax-payers may set off the balance of their assessed loss carried forward from a previous tax year for the purpose of determining their taxable income. The Commissioner disallowed such a set-off for the tax year ending 31 December 1995 on the ground that the tax-payers, two affiliated companies, did not carry on any trade and did not generate any income from trade in 1996, and hence that they were not entitled to set off losses from previous years in terms of s 20(1) of the Income Tax Act No 58 of 1962 as amended ('the Act'). On 13 April 2000 his decision was reversed by the income tax special court sitting in Bloemfontein. On 13 June 2002 the Commissioner appealed unsuccessfully to the full court of the Orange Free State Provincial Division. He now brings the matter before this court, with leave from the court a quo.

[2] The respondent companies conducted their business from the same premises with the same staff in the same manner. The only difference was that one of them confined its activities to dealing with retail outlets, the other with wholesale outlets. The issue that arose in their dispute with the Commissioner is identical.

The hearing before the income tax special court was conducted as a single hearing, and their appeal to the full court and to this court were argued as if they were a single appeal. It is convenient to deal with the matter in a single judgment.

[3] The respondents' trading activity was the arrangement and management of discounts for a chain of wholesale and retail supermarket and grocery outlets trading as Sentra Stores, Megasave, Value Stores, 8 Till Late, Pop 2000 and the Retail Management Group. The outlets joined one or other of the respondents as members. The respondents used the combined buying power of their members to arrange special discounts from suppliers. The members ordered stock directly from the suppliers who delivered directly to them. The respondents did not handle any stock themselves. They paid the suppliers on behalf of their members and in due course recovered these payments from their members. Their income was the difference between the rate of the discount they received from the suppliers and the rate of the discount they passed on to their members.

[4] On 1 January 1996 the respondents sold their entire business as a going concern to Shoprite Checkers (Pty) Ltd for a purchase price of R21 000 000. Their obligations under the

contract of sale included making payments to suppliers and collecting payments from members on behalf of Shoprite Checkers during a transition period while their members where transferred to the Shoprite Checkers organization. But they did not carry on their normal trading activity of recovering portion of the discounts for their own account during the 1996 tax year. During that tax year they received interest on the purchase price of R21 000 000 while it was being held in trust pending payment thereof to them on fulfilment of certain conditions, and, as from June or July 1996, interest on an investment of portion of the purchase price, R6 000 000, with Absa Bank. Of the balance of the purchase price, R6 000 000 was distributed to shareholders as a dividend, and R9 000 000 was invested free of interest in three Namibian companies. This investment was made with a view to the possible development of a similar chain store organization in Angola and other countries to the north, working through and with their Namibian associates. It is common cause that the respondents carried on various activities during the tax year, which were directed at exploring the possibility of a business in Angola similar to the business they had sold to Shoprite Checkers. I shall accept for purposes of the appeal, although it was not common cause, that they also sought to exploit wholesale liquor and firearm licences which had not been sold to

Shoprite Checkers. To both these ends considerable money, time and effort was expended by their directors, but no contracts were concluded, no organization was established, no active trading was done, and no income was earned.

[5] The respondent companies traded at a profit in the 1995 tax year. But they had both accumulated a sizable assessed loss which had been brought forward from previous tax years and which was set off against their profits. There remained a balance of assessed loss, which they sought to carry forward and set off against the interest income earned during 1996. The Commissioner's contention was that they were not entitled to do so in terms of the Act.

[6] Section 20(1) of the Act makes provision for setting off assessed losses to determine taxable income. It then read:

'(1) 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: Provided that....'

The interpretation given to this section by this court in *SA Bazaars (Pty) Ltd* v *Commissioner for Inland Revenue*[1] has consistently been followed and applied. The relevant portion of the judgment reads:

'Under sub-sec. (3) of sec. 11 the balance of assessed loss incurred in any previous year can only be set off when it has been carried forward from the preceding year of assessment. To succeed in this appeal the appellant must show that it was entitled to carry forward the balance of the assessed loss of £7,623 into its income tax return for the year ending 30th June, 1947.

During the year ending on 30th June, 1944, the appellant did not carry on any trade. The mere fact that it kept itself alive during that and subsequent periods does not mean that during those periods it was carrying on a trade. It is clear from the stated case that it closed down its business and as long as it kept its business closed it cannot be said to have been carrying on a trade, despite any intention it might have had to resume its trading activities at a future date. During the year ending on 30th June, 1944, therefore, the appellant did not carry on, within the meaning of sec. 11 (1), a trade within the Union and it derived no income from any trade. Under that sub-section a deduction or set-off is admissible only against income derived from carrying on a trade. As the appellant carried on no trade during the year under consideration it was not competent for it to set-off in its income tax return for that year the balance of assessed loss incurred by it in previous years. It is not necessary for the purpose of this case to decide whether the appellant would have been entitled

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[1] 1952 (4) SA 505 (A) at 510F – 511A, which deals s 11(1) and (3) of Act No 31 of 1941. The terms of the old sections are for present purposes identical to those which apply in

to set off that balance in respect of the year ending on 30th June, 1944, if during that year it had carried on a trade but earned no income. Cf. *Sub-Nigel Ltd* v *Commissioner for Inland Revenue,* 1948 (4) SA 580 at pp. 589 and 590 (A.D.).'

In once again quoting, approving and applying the principle in the *SA Bazaars* case, this court in *Robin Consolidated Industries Ltd* v *Commissioner for Inland Revenue*[2] said:

'Two propositions appear from this passage: set-off is admissible only (a) against income derived from trade; and (b) where the balance of assessed loss has been carried forward from the preceding year.'[3]

It is important to emphasize that in *Robin Consolidated Industries Ltd* this court did not decide the question left open in the *SA Bazaars* case. Schutz JA distilled the two propositions just quoted from the ratio of that case. It is in this context that the statement at 666G – 667A must be understood.

[7] The onus is on the tax-payer to establish these two propositions. The parties have accepted that if the first proposition is established the balance of the assessed loss at the end of the 1995 tax year may be carried forward for set-off. The Commissioner's argument was that the respondents have not proved that they carried on a trade during 1996, their activities

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this case.

[2] 1997 (3) SA 654 (SCA) per Schutz JA at 664G – 667A.

during that year amounting to no more than acts in preparation for trading at some time in the future. It was further argued on behalf of the Commissioner that there was no income derived from trade, the only income being interest on investments.

[8] The income tax special court and the full court held that the respondents' endeavours to set up a business in Angola along the lines of the business previously carried on by them in the Republic, and their endeavours to develop a similar business in liquor and firearms, did indeed amount to carrying on a trade within the meaning of the wide definition of trade given in the Act. The judgments set out in some detail the activities of the respondents in this regard. I am for present purposes prepared to accept that their decisions are correct.

[9] Counsel for the respondents submitted that the respondents have discharged the onus of proving the first proposition. He submitted that they have shown that they carried on a trade (which I have accepted) and that they had earned income against which to set off the balance of an assessed loss, ie the interest income from investment. He conceded that to succeed they had to overcome the hurdle of showing a connection between the trade

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[3] At 665B-C.

they carried on and the income they received. This concession is in effect a concession of the correctness of the argument by the Commissioner that the point left open in the *SA Bazaars* case – whether set-off can operate if a trade is carried on but no income is derived from it – should be answered in this case in favour of the Commissioner. I think that in the light the wording of section 20(1) and the wording of section 11(a) of the Act as it then read[4] the concession may have been correctly made. I prefer, however, to say no more on the point[5]. I must make it clear that no argument to the contrary has been placed before us, the point has not been given the consideration which contrary argument would require, and my decision is based on the concession.

[10] In order to overcome the hurdle counsel for the respondents did not attempt to relate the respondents' activities aimed at developing new business in new areas or with different products to their investment income. But he argued that the necessary connection between income and carrying on a trade is present

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[4] There is no material difference between section 11 then and now. It deals with general deductions allowed for determining taxable income. It is worded similarly to s 20(1) and deals with similar subject matter. The two sections should be similarly construed. At the relevant time, s 11(a) read: '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;….'

[5] Cf. Income Tax Case ('ITC') 1679 (1999) 62 SATC 294, ITC 664 (1948) 16 SATC 125 and ITC 777 (1953) 19 SATC 320, where differing conclusions are reached.

when regard is had to the wide definition given to the term 'trade' in the Act. He submitted that in deriving income from investing the proceeds of the sale the respondents had carried on the trade of an investment company. He sought to strengthen the point by showing from the financial statements that in the previous tax year they had also derived income from investments and had therefore carried on the trade of an investment company previously.

[11] This argument cannot be sustained. That the respondents derived some income from investments in past years, and that they did so during the year in question does not, without more, show that they carried on the business of an investment company. It is settled that in ordinary circumstances income in the form of interest on an investment is not income derived from carrying on a trade within the meaning of the Act.[6] It was, in any event, not the respondents' case that they carried on business as an investment company in 1996. On the contrary, they led evidence designed to establish that they intended to carry on the same kind of trade that they had conducted before because that was the area of their expertise. Their activities throughout 1996 were directed at finding ways and means (a) of developing a similar kind of business in

Angola, using Namibia as a springboard, and (b) of using their trading licences to develop a similar kind of business in liquor and firearms. To this end they made an interest-free investment of R9 000 000 in the Namibian companies, which would be a strange decision for an investment company to take. Strange, too, for an investment company was their decision to invest R6 000 000 with Absa Bank at a lower return than could otherwise have been achieved, because they wanted to ensure that the R6 000 000 would be readily available for the development of a new business in 1996 should the opportunity have arisen. When pressed, counsel for the respondents was unable to advance any sound reason why, in this case, the tax-payers carried on the business of an investment company by investing the proceeds of the sale of their previous business as a going concern. I conclude that they did not.

[12] The result is that the respondents have not shown that section 20(1) permits set-off of their assessed loss from trading during previous years against their income from interest on investments, their appeals to the income tax special court should not have been upheld, and the Commissioner's tax assessments

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[6] ITC 957 (1960) 24 SATC 637; ITC 1476 (1989) 52 SATC 141; ITC 1275 (1978) 40 SATC 197; ITC 512 (1941) 12 SATC 246.

for 1996 must stand. The order of the court is that the appeals are allowed with costs; the order of the court a quo is set aside with costs; and the order of the income tax special court is set aside and will be replaced with an order dismissing the appeals. The appellant does not ask for the costs of two counsel.

RJW JONES
Acting Judge of Appeal

CONCURRED: ZULMAN JA
BRAND JA
CLOETE JA
PONNAN AJA