44/94

Case No 392/92

IN THE SUPREME COURT OF SOUTH AFRICA
(APPELATE DIVISION)

In the appeal of:

COMMISSIONER FOR INLAND REVENUE ...... Appellant

versus

FELIX SCHUH (SA) (PTY) LTD............ Respondent

CORAM: CORBETT CJ, SMALBERGER, NIENABER, HOWIE, JJA, et OLIVIER AJA.

DATE OF HEARING: 22 February 1994

DATE OF JUDGMENT: 28 March 1994

J U D G M E N T

/CORBETT CJ:.....

CORBETT CJ:

This appeal, which comes to us direct from the Transvaal Income Tax Special Court, concerns the deductibility under sec 11(a) of the Income Tax Act, 58 of 1962 ("the Act"), of so-called "foreign exchange losses". In the Special Court the parties submitted, by agreement, a statement of facts and no evidence was led. From this statement and from the usual dossier the following picture emerges.

The respondent, Felix Schuh (SA) (Pty) Ltd, is a South African company. It is the wholly-owned subsidiary of a German corporation, Felix Schuh & Co GmbH ("Schuh"), whose main business is industrial insulation, painting and fire protection. Prior to February 1983 Schuh conducted business in South Africa from a branch in Johannesburg and was registered as an external company under the Act. In November 1982 the respondent was incorporated and in February 1983 a written agreement was entered into in terms of which Schuh sold its branch business in South Africa to the respondent. The purchase price of the business was its nett asset value as at the "effective date", which was agreed to be 1 January 1983, and it was to be paid by the issue to Schuh of shares in the respondent having an equivalent nominal value. The agreement was implemented.

During the 1983 tax year, which in respondent's case ended on 31 December 1983, the respondent borrowed an amount from Schuh and from Schuh's own holding company, G & H Montage GmbH ("Montage"). It was alleged by the respondent in its letter of objection that this and subsequent similar borrowings were incurred in order to provide the respondent with working capital. On 1 August 1983 the respondent received the proceeds of this first loan, which amounted in South African currency to R360 000. The loan was repayable, however, in Deutschmarks.

Between 1 August and 31 December 1983 the value of the rand as against that of the Deutschmark ("DM") declined substantially and on the basis of the rate of exchange prevailing on 31 December 1983 the indebtedness of respondent to Schuh and Montage expressed in rands, amounted to R370 509,16, i e R10 509,16 more than it was on the day that the proceeds of the loan were received by the respondent. This sum of R10 509,16 was taken into account by respondent as a deductible loss in its income tax return for the 1983 tax year. The deduction of this loss was apparently allowed by the appellant in the assessment of the respondent's taxable income for the 1983 tax year.

During the 1984 tax year a further amount of R200 000 was loaned to the respondent by Schuh and/or Montage. This loan was also repayable in DM. As a result of a further decline in the value of the rand as against the DM the respondent's total indebtedness in respect of these two loans expressed in rands as at 31 December 1984 stood at R730 382,65. This represented a further "loss" of R159 873,49, calculated as follows:

Total liability as at 31/12/84		R730 382,65
Less Total liability as at 31/12/83...........	R370 509,16	
Further loan	200 000,00	
		570 509,16
		R159 873,49

Again this amount of R159 873,49 was claimed and apparently allowed as a loss in the determination of the respondent's taxable income for the 1984 tax year.

No further loans were made during the 1985 tax year, but the value of the rand relative to the DM continued to decline. As at 31 December 1985 the respondent's total liability in respect of these loans expressed in rands amounted to R1 195 199,33. This represented a further increase in liability, or "loss", of R464 816,68. In its income tax return for the 1985 tax year the respondent, as before, claimed this last-mentioned amount as a deduction in the computation of its taxable income. This time, however, the appellant disallowed the deduction. The respondent appealed to the Special Court, which upheld the appeal and referred the matter back to the Commissioner. The Commissioner now appeals to this Court.

Certain other matters appearing from the statement of facts should be mentioned. Firstly, during the three tax years referred to no capital repayments on the loans were made by the respondent. Secondly, for the purposes of the present appeal no issue arises in respect of the 1983 and 1984 years of assessment. And, thirdly, it is agreed that the sole issue is whether the respondent is entitled "as a matter of principle" to deduct the sum of R464 816,68 in the 1985 tax year as being an "unrealised loss" resulting from exchange rate variations. The final paragraph of the statement reads:

> "If the Court holds that, as a matter of principle, the Appellant [now respondent] is entitled to the deduction, the Court is asked, in terms of section 83(13)(a) of the Act, to refer the assessment back to the Commissioner for further investigation, and assessment on the basis that a deduction should be allowed to the extent that the loans were raised and utilised by the Appellant for the purpose of expenditure that was not of a capital nature."

It is common cause that the resolution of this issue depends on whether a foreign exchange "loss" such as that referred to above constitutes, in terms of sec 11(a) of the Act, an expenditure or loss -

> ".... actually incurred in the Republic in the production of the income...."

The further question whether, accepting that it is such an expenditure or loss, it is of a capital nature or not does not, as I have indicated, arise for decision in these proceedings.

In coming to the conclusion that the respondent's foreign exchange "loss" was an expenditure or loss actually incurred in the Republic in the production of the income the Special Court relied mainly on three decisions: <u>Caltex Oil (SA) Ltd v Secretary for Inland Revenue</u> 1975 (1) SA 665 (A), <u>Plate Glass & Shatterprufe Industries Finance Co (Pty) Ltd v Secretary for Inland Revenue</u> 1979 (3) SA 1124 (T) and <u>Commissioner for Inland Revenue v General Motors SA (Pty) Ltd</u> 1982 (1) SA 196 (T). It is necessary to consider these cases in some detail.

In the <u>Caltex</u> case the taxpayer was a South African company carrying on business within the Republic as an importer, manufacturer and distributor of petroleum products. It was a subsidiary of a company incorporated in the United States of America. The taxpayer purchased its supplies of crude oil and other petroleum products and subsidiary supplies from two fellow subsidiaries both incorporated and carrying on business in the United Kingdom, viz Caltex (U.K.) Ltd ("Caltex UK") and Caltex Services Ltd ("Caltex Services"). The goods so purchased formed part of the taxpayer's stock-in-trade.

The taxpayer was obliged to pay for these goods in pounds sterling and the suppliers would invoice the taxpayer accordingly. Upon receipt of such an invoice the taxpayer would convert the purchase price shown therein (in pounds sterling) into rands at the prevailing rate of exchange between sterling and the rand and enter the converted amount in its books as the cost price of the supplies received in terms of the invoice. The taxpayer's tax year ended on 25 December.

On 18 November 1967 there were owing to Caltex UK and Caltex Services respectively the amounts of £4 659 486 and £48 925. These had been expressed in rands in the taxpayer's books of account as R9 353 920 and R98 217. On 19 November 1967 as a result of the devaluation of sterling on that date the rate of exchange between the rand and the pound changed from R2 to £1 (approximately) to R1,7207 to £1.

The amount owing to Caltex Services, viz £48 925, was paid by the taxpayer after 19 November, but before 25 December 1967. The discharge of this obligation cost the taxpayer in rand terms R84 186, i e R14 031 less than the amount owing prior to 19 November and as reflected in the relevant entries in the taxpayer's books of account. The amount owing to Caltex UK, viz £4 659 486, was not paid during the 1967 tax year, but as at the close of the financial year it was known that by reason of the devaluation and the then prevailing rate of exchange this obligation could be discharged at a cost to the taxpayer of R8 017 647, i e R1 336 271 less than the cost would have been but for devaluation and so much less than the amount reflected as owing in the taxpayer's books of account.

The question which then arose before the Special Court and later before this Court was whether in the determination of the taxpayer's taxable income for the 1967 tax year the full amounts of R9 353 920 and R98 217 should have been included in calculating the amount of "expenditure actually incurred" in terms of sec 11(a) by the taxpayer in the acquisition of trading stock during that year; or whether these amounts should have been reduced by the afore-mentioned amounts of R1 336 271 and R14 031 respectively. The taxpayer contended for the former approach; the Commissioner (or Secretary as he was then known) for the latter. The Special Court upheld the Commissioner's contention and the taxpayer appealed. For reasons which I shall elaborate this Court dismissed the appeal.

In the judgment of this Court (delivered by Botha JA) a number of important preliminary points were made. In the first place, it was pointed out that it was common cause that the expenditure incurred by the taxpayer (appellant) in the acquisition of the goods in question was incurred in the production of its income, that such expenditure was not of a capital nature and was wholly expended for the purposes of the appellant's trade. The sole question was whether or not the two sums which the appellant was by reason of the devaluation of sterling not required to expend in rands in order to discharge its obligations in sterling to its suppliers could be said to be part of the "expenditure actually incurred" in terms of sec 11(a) (see Caltex judgment, at 673 F-H).

The second point which was emphasized was that income tax is assessed on an annual basis in respect of the taxable income received by or accrued to the taxpayer during the year of assessment; that in determining such taxable income there is in terms of sec 11(a) deductible from income expenditure actually incurred by the taxpayer during the year of assessment; and that it is only at the end of the year of assessment that it is possible, and "then it is imperative", to determine the amounts received or accrued on the one hand and the expenditure actually incurred on the other hand during the year of assessment. (See at 674 B-D.)

The third preliminary point made was that "expenditure actually incurred" does not mean only expenditure actually paid during the year of assessment, but means all expenditure for which a liability has been incurred during the year, whether the liability has been discharged during that year or not. It is in the tax year in which the liability is incurred and not the year in which it is actually paid (if paid in a subsequent year) that the expenditure is "actually incurred". (See at 674 E-F.)

The judgment then proceeded to deal with the obligation (to Caltex Services) which was actually discharged by payment during the 1967 tax year and held that the appellant actually discharged its obligation by expending R14 031 less than the amount of R98 217 entered in its books of account. Said Botha JA (at 675 A-C):

> "It seems to me quite impossible to say that, merely because the higher amount of R98 217 was entered in appellant's books of account as the equivalent, as at the date of the relevant transactions, of £48 925 sterling, the expenditure actually incurred in connection with the Caltex Services Ltd transactions was anything more than the amount actually expended by the appellant. ....
> It is important to bear in mind that the

> liability to Caltex Services Ltd. was incurred in sterling and not in rands, and the amount of expenditure actually incurred for the purpose of sec 11 (a) can only be the amount required in rands to discharge that liability in the tax year in which it was incurred."

Turning to the liability to Caltex UK, the Court held that the position was no different in principle. At the end of the 1967 tax year the appellant owed this creditor £4 659 486, but since sterling was not legal tender in South Africa this obligation had to be quantified in rands as at the end of the financial year for the appropriate deduction to be made in the appellant's income tax return. This quantification had to be made at the rate of exchange prevailing at the end of the fiscal year. (See at 675 E-H.) In support of this conclusion Botha JA stated (at 675 in fin - 676 A):

> "Were it otherwise a completely unrealistic result would be achieved in that a trader would be allowed, for the purpose of determining his taxable income for the year of assessment, to deduct from his income moneys which he in fact did not expend or for the payment of which he incurred no liablity in the production of his income during that year, and which could not be said to have been 'wholly or exclusively laid out or expended for the purposes of trade' in terms of sec 23(g) of the Act. I agree with counsel for the respondent that it would be doing violence to language to suggest that, where a trader has incurred a liability to pay a fixed amount for trading stock during any tax year, and that amount is for any reason reduced during that year and before it is paid, the amount of the expenditure actually incurred by that trader during that year was the original amount agreed upon and not the reduced amount."

In the Caltex case it was argued on behalf of the appellant that where a trader incurred liability to pay for trading stock in a foreign currency it was necessary in terms of our taxation laws that the relevant transaction and the amount owing be reflected in the trader's books of account in terms of South African currency, that the conversion from the foreign currency to rands be made at the date of the relevant transaction and that the amount so reflected in rands be regarded as the amount of the expenditure actually incurred by the trader for the purposes of sec 11(a), irrespective of subsequent fluctuations in the applicable rate of exchange. (See at 676 E-F.) The Court gave the following reasons for rejecting this argument (at 676 G - 677 A):

> "It is true that for the purposes of the Republic's taxation laws it was necessary for the appellant to reflect in its books of account its trading operations with Caltex Services Ltd. and Caltex (U.K.) Ltd. in South African currency, and that the conversion from

sterling to rands was therefore made according to the rate of exchange prevailing at the relevant time. Although the amount so converted reflected the liability incurred by the appellant expressed in South African currency at the time of the conversion, it did not follow that that amount so expressed would remain unchanged until the discharge of the liability in sterling or until the end of the tax year when the deductions in respect of the expenditure actually incurred by the appellant came to be made under sec 11(a). The Court is only concerned with deductions permissible according to the language of the Income Tax Act and not debits made in a taxpayer's books of account for deduction even though considered proper from an accountant's point of view. (Joffe & Co Ltd v Commissioner for Inland Revenue, 1946 A D 157 at p 165.)"

Finally the Court emphasized (at 677 G-H):

"We are here concerned only with the case where the foreign currency is devalued in the same tax year in which the liability to make payment in that currency was incurred, and before that liability is discharged. We are not concerned with the case where the devaluation occurs in a subsequent year before the liability is discharged. In the latter case the quantification, for the purpose of sec 11(a), at the end of the tax year, of the expenditure actually incurred during that year, is not affected by the subsequent devaluation of the foreign currency (cf The British Mexican Petroleum Company case, supra), but in such a case the devaluation may attract other tax consequences in the fiscal year in which the devaluation takes place, depending upon whether or not the tax legislation provides for such a contingency, expressly or impliedly. It is not necessary in this case to express any views on that aspect of the matter."

I turn now to the Plate Glass case (supra). In this case the taxpayer (appellant) was a company in a large group, comprising domestic and foreign companies. It was formed to look to the financial requirements of the group. A loan was obtained from a Swiss bank by a member of the group, which in turn lent 10 million Swiss francs (the major part of the loan) to the appellant, which "on-lent" the money to other members of the group. It was arranged that three million Swiss francs would be regarded as an outright, indefinite period, interest-bearing loan, repayable on demand; whereas in respect of the balance of seven million Swiss francs promissory notes were to be issued for 120-day periods on a so-called "roll-over" basis. In its income tax returns for the 1974 and 1975 fiscal years the appellant claimed as deductions losses on this loan transaction by reason of unfavourable changes in the rate of exchange between the rand and the Swiss franc. The deductions were disallowed and an appeal to the Special Court failed, as also did an appeal to the full bench of the Transvaal Provincial

Division. In the judgment of the full bench (which is reported at 1979 (3) SA 1124) it was noted that the appeal raised three issues: (i) whether any losses were actually incurred by reason of the exchange rate fluctuations; (ii) if there were such losses, whether they were incurred by appellant, and not some other company within the group; and (iii) whether such losses were suffered in the production of the income and were not of a capital nature. The full bench (per Margo J, Eloff and Preiss JJ concurring) held that the appellant had failed to prove that the losses were not of a capital nature and accordingly dismissed the appeal. In regard to issue (i) above, the President of the Special Court, Trengove J, had stated with reference to the outright loan of three million Swiss francs (I quote from the unreported judgment):

> "The outright loan of Sw. Fr. 3 000 000 was granted in April 1972, and at a

foreign exchange rate of Sw. Fr. 5,208 to the R1,00 (which was the conversion rate as at that date) the amount available to the appellant, for its purposes, would have been approximately R576 037. This is the amount at which the loan would have been reflected in the appellant's books of account, in April 1972. This amount was still available to the appellant and in its hands as circulating capital during the 1973 and 1974 tax years; according to the evidence, there was no demand for the repayment of this loan during the tax years in question. If such a demand had been made, and the appellant had been obliged to repay the loan it would undoubtedly have incurred a loss in doing so, as a result of the deterioration in the rate of exchange. But, in my view, it cannot be contended that the appellant has, as yet, incurred any actual loss on this loan as a result of the adverse foreign exchange rate. While it is no doubt in accordance with the principles of sound accountancy to make some provision in the balance sheet for such an eventuality and to reflect the extent of

> the appellant's liability in respect of the loan at the current rate of exchange, a loss, reflected in the balance sheet for this purpose, would not, in my view, constitute a loss actually incurred, as envisaged in section 11(a) of the Act."

In the judgment of the full bench reference is made to this passage in the reasons of Trengove J (see at 1127 H) and the following observation is made thereon (at 1127 in fin - 1128 D):

> "On the other hand, it seems to me that there is logic in adopting the accounting method to determine liabilities or losses, whether on capital account as set forth in a balance sheet as at a particular date, or on a trading account covering a particular period. The expression 'expenditure..... actually incurred', in s 11(a) of the Income Tax Act, does not mean expenditure actually paid during the year of assessment, but means all expenditure for which a liability has been incurred during the year, whether the liability has

been discharged during that year or not. It is in the tax year in which the liability for the expenditure is incurred, and not in the tax year in which it is actually paid (if paid in a subsequent year), that the expenditure is actually incurred for the purpose of s 11 (a). See Caltex Oil (SA) Ltd v Secretary for Inland Revenue 1975 (1) SA 665 (A) per Botha JA at 674D-F. That applies equally to losses, for s 11 (a) refers to 'expenditure and losses actually incurred'. Here, since part of the loan was repayable on demand, and the rest was repayable on demand at the end of any of the 120-day periods, the liability continued for each tax year until it was repaid. If, in a case such as the present, after such a liability has been brought to account in an increased amount because of a loss caused by a change in the rate of exchange, there should be an improvement in the rate of exchange resulting in a profit, or in a reduction of the loss, that would have to be accounted for as at the later date or in the later trading period. The ultimate

> actual profit or loss would then be properly brought to account in this way. For a short discussion on this method, and its acceptability, see Simon **Taxes** 3rd ed vol B para B1.1101 at 542-543."

In view of the fact that the Court's decision was founded on the capital or revenue nature issue, these remarks must be regarded as **obiter dicta.**

My reference to the General Motors case (supra) need not be more than brief for it dealt with a principle which does not arise for decision in this case and upon the correctness of which I do not propose to express any opinion. The case concerned certain foreign loans made to the taxpayer (respondent before the Court) and (unlike the present case) repaid by the respondent during the 1976 tax year. The loans were repayable in foreign currencies and owing to changes in rates of exchange the respondent had to pay more in rand terms when repaying than it had received, in rand terms, when the loans were granted. The question which arose in that case was whether these "foreign exchange losses" were on capital or revenue account. The Court (a full bench of the Transvaal Provincial Division consisting of Irving Steyn, Le Grange and McCreath JJ) held that in order to determine this issue it was necessary to have regard to the "substance and reality" of the transactions in question; and that, inasmuch as the loans, so regarded, were for the purpose of acquiring trading stock, and did not form part of the respondent's "infrastructure", losses incurred in the repayment of the loans were of a revenue nature.

Reverting to the present case, I would point out that the President of the Special Court (Melamet J) stated in the judgment of the Court (with reference to the Caltex, Plate Glass and General Motors cases) that:

> "The effect of the three judgments, read in conjunction, is that an unrealised

> foreign exchange loss relating to a loan raised for working capital purposes must be taken into account for income tax purposes at the end of the year of the assessment irrespective of the year in which the proceeds of the loan were received by the borrower."

It was argued before the Special Court on behalf of the Commissioner that the losses in question were not "actually incurred" in terms of sec 11(a) in that at the end of the tax year in question they were merely notional losses and were conditional on the actual rate of exchange prevailing at the time of repayment. Melamet J rejected this argument and stated:

> "When a taxpayer owes an amount expressed in a foreign currency and the amount is owed unconditionally and uncontingently there is, with certainty, an amount of expenditure actually incurred. Fluctuations in the rate of exchange can only affect the amount or quantification of the

> certain liability. It is only the quantification that is contingent - the liability itself is absolute. On this basis, a deduction for an unrealised loss falls within the basic principles for deduction in terms of section 11(a) of the Income Tax Act."

While not necessarily accepting all the reasoning in the obiter dicta (quoted above) in the Plate Glass case, Melamet J nevertheless agreed with the conclusion reached therein and regarded himself bound thereby.

With respect, I am unable to agree with either the reasoning or the conclusion of the Court a quo. In my view the so-called foreign exchange "loss" claimed as a deduction under sec 11(a) by the respondent in this case was not a loss "actually incurred.... in the production of the income". In principle it seems to me that it makes no difference whether there were one or more loans or whether the loans in question were made during the 1985 fiscal year or in a previous year; and so for the sake of simplicity I shall, in discussing the case, treat them as a single loan made, but not repaid, during the 1985 tax year. I shall also assume that the actual proceeds of the loan, in rand terms, when received by the respondent was R730 382,65; and accept that as at 31 December 1985 it would, in rand terms, have cost the respondent R1 195 199,33 to repay the loan: hence the so-called loss of R464 816,68.

Sec 11(a) speaks of "expenditure" and "losses". The distinction between these two concepts has been discussed by this Court relatively recently in the cases of Stone v Secretary for Inland Revenue 1974 (3) SA 584 (A), at 593 E - 594 H; Burman v Commissioner for Inland Revenue 1991 (1) SA 533 (A), at 536 D - F; Solaglass Finance Co (Pty) Ltd v Commissioner for Inland Revenue 1991 (2) SA 257 (A), at 279 B - H). Broadly speaking, as these cases show, "expenditure" refers to disbursements or expenses incurred or paid voluntarily, whereas "losses" connote involuntary deprivations occurring fortuitously. In individual cases, however, it may be difficult to decide which side of the dividing line a particular outgoing falls.

In the present case appellant's counsel submitted that the deduction claimed by the respondent should be categorized as a loss because it was an involuntary liability arising from the extraneous and fortuitous occurrence of an adverse decline in currency exchange rates. I am inclined to agree, but I do not think that this categorization is of critical importance. The real question is whether, by reason of currency fluctuations, the respondent actually incurred during the year of assessment any outgoing or liability in respect of its foreign loan which could be classed as either an expenditure or a loss in the production of the income.

In this connection it is important to obtain clarity on precisely what it is that the respondent seeks to deduct. The respondent was lent a sum of money and it incurred an obligation to repay this capital sum in DM on some unspecified (and, during the relevant tax year, unascertained) future date. The loan and the obligation to repay by themselves have no fiscal consequences whatever. They do not figure in either the computation of the respondent's receipts and accruals or in the determination of its deductible expenditure and losses for the tax year in question. The loan itself is what has been termed "a neutral factor". But because the loan has to be repaid in a foreign currency, viz DM, there is inherent in the transaction the possibility that when repayment is eventually made exchange rate fluctuations may result in the respondent having to pay in rands either more, or perhaps less, than it originally received in rands from the lender. If in some future fiscal year when repayment is made to do so costs the respondent more in rands than the capital amount in rands which was originally advanced to it, then it will have incurred a loss which, provided the other requirements of sec 11(a) are satisfied, will be deductible. But it will only be deductible in the year of repayment because only <u>then</u> will such a loss have <u>actually</u> been incurred. To my mind, it is as simple as that.

The reliance of the Court a **quo**, and of respondent's counsel, on the decision of this Court in the <u>Caltex</u> case is, with respect, misplaced. In that case this Court dealt with an instance of expenditure **par excellence**, viz the purchase price of stock-in-trade acquired by the taxpayer during the fiscal year in question. An absolute and unconditional (cf <u>Commissioner for Inland Revenue v Golden Dumps (Pty) Ltd</u>

1993 (4) SA 110 (A) at 117A - 118 H, and the cases there cited) obligation to pay for the goods was incurred during that fiscal year. In respect of the one creditor payment was made during the year, but after devaluation. The Court held the amount to be deducted in terms of sec 11(a) was the amount in rands which it actually cost the taxpayer to make this payment. The factual situation in respect of the other creditor is more relevant to the present case in that at the end of the fiscal year the obligation remained undischarged. Nevertheless, for the reasons which I have fully indicated in dealing with the Caltex case, at that year-end this obligation had to be quantified. This was because only in that fiscal year was the expenditure actually incurred and, therefore, only in that fiscal year could the deduction be claimed. The problem which arose did not relate to the question as to whether expenditure had actually been incurred: clearly it had. The problem related merely to the question whether in quantifying that expenditure regard should be had to the original invoiced price of the goods in rands, as it was before devaluation and as it was reflected in the taxpayer's books, or to the outstanding price owing in rands as at the end of the fiscal year and taking into account devaluation. The Court chose the latter basis of quantification. That the problem in question was merely one of quantification and did not relate to the issue as to whether expenditure had actually been incurred appears clearly from the Court's judgment (see at 675 H, 677 H, 678 A - D). The Caltex case is thus clearly distinguishable from the present case and is not authority for the submission that where a loan debt repayable in a foreign currency remains undischarged at the end of a fiscal year and it appears that owing to an adverse change in exchange rates more rands would then notionally be required to repay the debt than would have been the case when the money was first advanced such increase constitutes a loss actually incurred in that fiscal year. Moreover, as I have indicated, the submission itself is unsound. It follows that the **obiter dicta** in the judgment of the full bench in the Plate Glass case must be similarly regarded and the above-quoted remarks of Trengove J in the Special Court preferred.

It is true that where such adverse alterations in the exchange rates take place and continue year by year the prudent borrower will no doubt make annual provision for the possible additional cost (in rands) of discharging the loan obligation. And this provision will be reflected in his books and annual accounts. But this cannot affect the income tax position as I have expounded it. As has frequently been pointed out, the Court is concerned with the deductions permitted in terms of the Act and not with debits or other provisions made in a taxpayer's accounts, even though these may be regarded as prudent and proper from an accounting point of view.

The main argument of counsel for the respondent was that the deduction of the foreign exchange "loss" claimed was justified on the authority of the Caltex case. I have dealt fully with this argument. In the alternative, counsel argued that there were in truth two sets of transactions: the loan transaction and the transaction whereby the proceeds of the loan (in DM) were converted by the bank into rands at respondent's instance. The argument, as I understand it, is that by so converting the respondent exposed itself to the risk of loss in the event of an adverse change in exchange rates as between the rand and the DM. By the end of the fiscal year this adverse change had materialized and an "absolute liability" to pay an additional amount in rands in order to acquire the DM required to repay the loan had come into existence. This increase in liability was "in the nature of a cost" and was an amount of expenditure and loss within the meaning of sec 11(a).

This argument cannot succeed. In the first place, it lacks a factual foundation. Neither the statement of facts nor the dossier discloses how the loan was made available to the respondent and there is no basis for holding that the respondent was party to a conversion transaction with the bank. Furthermore, the point that it is this conversion transaction and not the loan itself which gives rise to the expenditure or loss was never taken in the letter of objection. However, even if one ignores these difficulties and assumes in respondent's favour that there was such a conversion transaction with the bank, I am satisfied that the argument has no merit. Firstly, in substance and reality there was one transaction, viz the loan. The conversion of the proceeds of the loan from DM to rands in order to enable the respondent to make commercial use of the loan in South Africa was merely part of the practical mechanics of giving effect to the loan. Secondly, the conversion of the DM into rands constituted neither an expenditure nor a loss. It was simply a currency conversion. The respondent expended nothing; it merely received in rands the proceeds of the loan to it. **A fortiori** there was no loss. Nor did the situation change at the end of the fiscal year. There was still no expenditure or loss which had then to be quantified. As I have already emphasized, such expenditure or (preferably) loss could only occur when the respondent had to provide rands to purchase the necessary DM to repay the loan. That did not happen during the tax year in question.

During the course of argument counsel on both sides referred us to decisions of the Australian and English courts. In my view, however, the position in our law is clear and it is not necessary to seek persuasive authority elsewhere. Nothing that I have read in those judgments would, however, appear to be adverse to the conclusion I have reached in this case.

Finally, I must mention certain amendments to the Act. The first is the sec 24 B which was introduced by sec 13(1) of Act 104 of 1979 and dealt with realized gains or losses on the repayment of loans or advances in foreign currency. This clearly had no application in the present case. The second is the new sec 24 I introduced by sec 21 of Act 113 of 1993, which deals with realized and unrealized foreign exchange gains and losses which came into operation only on 1 January 1994 and does not affect this case.

The appeal is accordingly allowed with costs, including the costs of two counsel. The order of the Court a quo is set aside and is replaced by an order dismissing the appeal.

M M CORBETT

SMALBERGER JA)
NIENABER JA)
HOWIE JA)
OLIVIER AJA)

CONCUR