105/98

REPUBLIC OF SOUTH AFRICA

THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

CASE NO: 1/97

In the matter of:

CACTUS INVESTMENTS (PTY) LIMITED Appellant

and

THE COMMISSIONER FOR INLAND REVENUE Respondent

CORAM: Hefer, Howie, Schutz, Scott JJA et Farlam AJA

HEARING: 5 November 1998

DELIVERED: 20 November 1998

J U D G M E N T

HEFER JA

Normal tax is levied in terms of s 5(1) of the Income Tax Act 58 of 1962, as amended, on income received by or accrued to a person during the year of assessment. "Gross income" is defined in s 1 as

> "the total amount, in cash or otherwise, received by or accrued to *or in favour of such person during [any] year or period of* assessment . . . excluding receipts or accruals of a capital nature."

This includes, as explained in *Commissioner for Inland Revenue v People's Stores (Walvis Bay) (Pty) Ltd* 1990(2) SA 353 (A), not only income actually received, but also rights of a non-capital nature which accrued during *the relevant year and are capable of being valued in money.*

When the events occurred to which the present appeal relates the appellant ("Cactus") was a subsidiary of Union Acceptances Limited ("UAL"). UAL traded as a merchant bank and Cactus's main function was to hold and manage its preference share book. Initially this involved no more than purchasing preference shares in other companies and issuing similar shares of its own. But during 1987 a scheme was devised to enable Cactus to make interest-bearing investments without attracting liability for income tax.

It involved the exchange of taxable interest income for non-taxable dividend income by way of cession and counter cession. The scheme was put into operation during 1988. During that year and 1989 Cactus made several interest-bearing fixed deposits and loans, and executed a number of cessions of its right to receive the interest. In return it took cession of rights to receive dividends.

The respondent assessed the interest as subject to normal tax during the 1988 and 1989 tax years. After an objection to the assessments had been disallowed, Cactus appealed in terms of s 83 of the Act. The special court found that the interest had been ceded before its accrual and set aside the assessments. However, in an appeal by the respondent under s 86A, the Transvaal Provincial Division of the High Court reversed the special court's decision (*Commissioner for Inland Revenue v Cactus Investments (Pty) Ltd* (1997) 59 SATC 1). The majority of the court (Southwood J and Ginsburg AJ) held that the right to claim interest accrued to Cactus on the days on which the investments were made and was not affected by the subsequent cessions. In a separate judgment Wunsh J came to the conclusion that the interest vested only when the investments matured, but

that it was deemed to have accrued to Cactus in terms of s 7(1) of the Act. He agreed with the majority that the accrual occurred during 1988 and the assessment for that year was accordingly confirmed.

Argument in this Court centred mainly on Cactus's obligations under the agreements in terms of which the loans and deposits were made. Mr *Solomon*, who appeared for Cactus, supported the special court's view that

> "[h]aving regard to the nature of a contract of loan, in the present [case] where interest is payable only at the end of a fixed period, the lender's entitlement to interest is conditional upon his willingness and ability to make the money available to the borrower for the whole of the fixed period; and therefore the right to the interest does not accrue to him until the end of the fixed period, unless the contract otherwise provides."

Mr *Derksen,* who appeared for the Commissioner, supported the judgment of the majority in the court *a quo* to the effect that

> "[t]he respondent had only one obligation in terms of the agreements and that was to pay over the agreed sum of money to the borrower. There was no other continuing obligation to make the money available to the borrower for the full period of the agreement . . . Therefore when the respondent entered into the agreements . . . it immediately acquired the right to claim payment of the capital and the interest."

We must consider these conflicting views bearing in mind that we are dealing with a statute which has left the concept of accrual undefined. The judgment in the *People's Stores* case tells us that no more is required for an accrual than that the person concerned has become entitled to the right in question. Accordingly, apart from cases falling under s 7, the entitlement to any particular right is regulated by the common law. In the present case we are dealing with loans for consumption and it is to the common law principles relating to loans of this kind that we have to look in order to find an answer to our problem.

I say this because Mr *Solomon* referred us to Watermeyer CJ's judgment in *Commissioner for Inland Revenue v Lever Bros and Another* 1946 AD 441. In that case the Chief Justice, in an entirely different context and dealing with "loans" in the form of credit given to the "borrowers", said (at 451) that the "supply of credit is the service which the lender performs for the borrower, in return for which the borrower pays him interest". In the present case Cactus did not give its customers credit; we are dealing with ordinary loans for consumption and with money actually paid to borrowers. The interest which they were obliged to pay was certainly not to compensate

Cactus for any service rendered to them. In the *Lever Bros* case Watermeyer CJ illustrated his remarks by referring by way of analogy to the relationship between a lessor and a lessee. Mr *Solomon* sought to do likewise. In the situation which the learned Chief Justice envisaged the analogy of a lease may have been apt but in the present situation it is not a true analogy at all. Rent can obviously be regarded as compensation to the lessor for the use of his property and the lessor can (depending on the terms of the agreement) rightly be said to have continuing obligations apart from making the subject of the lease available to the lessee. But, bearing in mind again that we are dealing with loans for consumption which brought about that each borrower became the owner of the money received, the interest cannot be compensation to Cactus for the use of Cactus's money. Moreover, Mr *Solomon* rightly conceded that no physical performance was required of Cactus apart from paying the amount of each loan to the borrower. He was unable to explain the content of the continuing obligation for which he contended.

My view of the matter, like that of the majority in the court *a quo*, is a simple one, provided we do not lose sight of the reason for the quest for a

moneylender's obligations. What we are trying to ascertain, is whether, after making the funds available to the borrower, the lender has an unconditional right to receive the interest on due date. The question is really one of reciprocity. It is trite that the reciprocity of obligations under synallagmatic agreements entails that neither party is entitled to demand performance from the other until he has performed himself. Thus, if a moneylender has not made money available to the borrower, a demand for interest will obviously be met by the *exceptio non adimpleti contractus*. But, if he does make the money available and demands interest before due date, his claim will be defeated, not by the *exceptio,* but by the simple fact that the time for repayment has not arrived. I agree with the majority of the court *a quo* that

> "the respondent's right to claim interest was not subject to any further performance of any obligation by the respondent. It was simply subject to a time provision ('tydsbepaling') . . ."

For this reason I respectfully reject the following remark in Wunsh J's judgment (at 25):

> "If a lender were to sue a borrower for the whole interest immediately after it had advanced the loan, the fundamental defence would be that the loan had not run its course, *that it had not completed its performance.*" (Own emphasis.)

The words in italics are somewhat at odds with what precedes them and imply an obligation which does not exist. As I understand his judgment, Wunsh J accepted that a lender indeed has a continuing obligation apart from paying the borrower the amount of the loan. What such an obligation involves, is not spelled out; it is merely said (at 21) that

> "the lender's obligation is not merely to make the funds available to the borrower by paying them over to it but also to maintain their availability for the duration of the loan."

With respect, how does the lender maintain the availability of the funds after paying them over? How does he do so when the money belongs to the borrower?

I have been dealing so far with the principles relating to loans for consumption in general. Because the parties are at liberty to make other arrangements it is necessary to refer to the terms of the loans and deposits (which are in effect also loans) in the present case. The terms are quoted in the majority judgment of the court *a quo;* apart from provisions in the agreements with Bullion Merchants of SA Ltd relating to the accrual of the interest, with which I will deal, they do not reveal anything worth mentioning.

As Southwood J said at 15,

> "[a]ll the agreements were very clear. The respondent (Cactus) undertook to lend a fixed sum of money to the borrower for a fixed period at a fixed rate of interest and the borrower undertook to repay the capital and pay the interest to the respondent on a fixed date. "

There is nothing in any of the agreements indicating that the ordinary principles of the common law would not apply. The agreements with Bullion Merchants did contain express provisions to the effect that "interest will accrue" on fixed future dates. (One of the agreements is quoted at 11-12 and the relevant provision appears in clause 4 at 12.) The effect was, so Mr *Solomon* argued, that interest could not accrue on any earlier date. In my judgment, however, although a taxpayer is entitled to arrange his affairs in such a manner that the fruits of his labour or money will attract no (or less) or later tax, a stipulation that interest will accrue on a date after the date on which it accrues *ex lege*, avails him not.

I revert to Wunsh J's judgment. Because much of what the learned judge said therein has no real bearing on the case I will confine myself to two aspects. My understanding of the judgment is that the conclusion that the

right to receive interest did not accrue immediately is based on two grounds. The first is that Cactus had a continuing obligation after paying the borrowers the amounts of the loans. I have dealt with this.

The second ground is stated at 27, namely:

> "I do not consider that the intention of the legislature could have been to establish a regime so far at variance with commercial realities and legal principles as Mr *Derksen* has suggested."

A good example of the commercial realities referred to is mentioned at 22; a loan for 10 years with interest payable periodically in arrear at a fixed rate. I entirely agree with the learned judge's observation that "a rational regime would treat the interest as having accrued to the lender and having been incurred by the borrower on the due dates for payment." I am aware of the fact that an application of the concept of accrual which does not take account of commercial realities may operate harshly inasmuch as it requires that tax be levied on income which may be received only in the very distant future. (Cf 44 (1995) *The Taxpayer* 62.) However, it is often said (cf ITC 268 7 SATC 157 at163) that there is no equity in tax legislation (nor, I would add, complete rationality). The inequity of levying tax on income which will only

be received in future is inherent in the system of receipts and accruals, which has been with us for many years. As long as the system prevails inequitable results cannot always be avoided. Of course, the Act must be interpreted and applied in the least onerous manner which its wording allows. But, if the wording is clear, it must be applied however harsh the result might be. The taxpayer's remedy is to arrange his affairs, so far as he is able, so as not to attract these results.

As I have indicated, the expression "accrued to" in s 5(1) and the definition of "gross income" has been interpreted in the *People's Stores* case to mean "has become entitled to". Neither Wunsh J in the court *a quo* nor Mr *Solomon* in this Court has suggested any other meaning. I have also indicated that at common law, unless the parties otherwise agree, a lender of money becomes entitled to the right to receive interest on the stipulated future date, as soon as he has made the funds available to the borrower. This is the plain effect of the Act as it stands and we cannot on equitable grounds apply it in any other manner.

My conclusion is that the judgment of the majority in the court *a quo* is correct. It is accordingly unnecessary to deal with the alternative grounds on

which Mr *Derksen* supported the 1988 assessment, or with Wunsh J's view that the interest is deemed to have accrued to Cactus under s 7(1). It may be mentioned in conclusion that the accrual of interest is now regulated by s 24 J of the Act which was inserted by s 21(1) of Act 21 of 1995.

The appeal is dismissed with costs.

JUDGE OF APPEAL