



**AN EXPLORATION OF WHETHER THE VALUATION OF AMOUNTS
FOR GROSS INCOME SHOULD ADOPT A SUBJECTIVE OR
OBJECTIVE APPROACH**

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DECLARATION

I, Thandolwenkosi Linda Nzima (215080973) hereby declare that this is my own work and that it has not previously been submitted for assessment or completion of any postgraduate qualification to another University. It is hereby submitted in partial fulfilment of the requirements for the award of Degree of Master of Laws in Taxation.

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TL. NZIMA

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ABSTRACT

The goal of this dissertation is to offer an investigative comparison between the subjective and objective approaches that are adopted by the courts in evaluating an amount for inclusion in the gross income of a taxpayer. There is much scholarly debate which questions the approach that is both favourable and practical for the taxpayer, so as to aid the Commissioner for the South African Revenue Service (CSARS) to make provisions for its regulation. For purposes of this dissertation the discussion shall be centred on amounts whether in money or other non-monetary property, and not receipts distinctly. Conducting an analytical comparison between the two approaches is pivotal as it seeks to address a historically grey area in which the courts have struggled to answer the question as to which approach is concrete enough to be applied by both the courts and the revenue services.

A subjective approach take into cognisance the taxpayer's state of mind and intentions leading to contracts and business transactions. SARS will look into the taxpayer's motive when making an assessment on the receipt or accrual of an amount for gross income purposes. The subjective approach maintains that the taxpayer's intention during the business transaction is a reflection of the true characteristic of the operation. Should the matter come before the courts, a presiding officer will scrutinize the chain of events that reveal the state of mind of the taxpayer during alienation of an asset.

Where a court employs the objective approach the norm is that set rules must be complied with by the court and the taxpayer's state of mind during the economic transaction will be irrelevant. Surrounding factors such as the how as well as when a commodity was purchased and the actions of both contracting parties during the contract will be determinants in the quantification of the amount. If the business transactions satisfy all or some of the rules in the court's rubric then the amount will be deemed taxable.

Ensuing chapters will highlight the benefits and shortcomings of each approach, and will display which approach is favourable within democratic countries.

Recommendations offered in this dissertation are that the status quo be maintained to promote a consistent tax system. Currently income is levied according to the strict objective approach

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where all taxpayers' amounts will be assessed according to the surrounding circumstances that occurred prior, during and after transactions. This will be discussed in detail in the ensuing chapters.

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CHAPTER ONE

INTRODUCTION AND BACKGROUND

1. Introduction

Section 1 of the Income Tax Act¹ defines ‘gross income’ and places the burden of determining a person’s² liability for normal tax on SARS. The ‘gross income’ definition encompasses numerous elements that need to be fulfilled for amounts to be deemed taxable. ‘Taxable income’ in the Act includes, where residents³ are concerned, the entire amount that they receive or that shall accrue to them, in the form of money or property, provided it is not capital in nature. Should the amount received by a taxpayer satisfy all the ‘gross income’ requirements the amount will be included in gross income and the taxpayer will be taxed accordingly.

A regular occurrence in modern business transactions is that amounts received are not ordinarily cash, contrary to the ‘in cash’ provision of the ‘gross income’ definition. Distinctive examples of such transactions include the right to use of property, the awarding of shares or a holiday, loans as well as barter exchanges. Such problems are resolved by valuing the merx⁴ or benefit and assigning a suitable market related price to include an amount in the taxable income of that person. Valuation of the right or loan is necessary to establish a value in monetary form.

¹ Income Tax Act 58 of 1962.

² Person includes both legal and natural persons. The term also encompasses trusts, deceased estates and insolvent estates.

³ A ‘resident’ is defined in the Act as a natural person who is;

- i. Ordinarily resident in the Republic; or
- ii. Not at any time during the relevant year of assessment ordinarily resident in the Republic, if that person was physically present in the Republic-
 - aa) for a period or periods exceeding 91 days in aggregate during the relevant year of assessment;
 - and
 - bb) For a period or periods exceeding 915 days in aggregate during those five preceding years of assessment.

⁴ A thing or property.

‘To overlook non-cash income is to undermine the essential purpose of the income tax which is not purely to raise revenue but to distribute the tax burden to each and every taxpayer according to their economic capacity’⁵ hence all forms of receipts ought to be valued.

Valuation of assets is the focal point of this dissertation as it not only lays the foundation for the debate pertaining to the approaches in valuing assets to determine taxable income, but also evaluates if those approaches are in contravention of taxpayer’s rights. There are two approaches to determining an amount namely the subjective and the objective approach.

1.2 The Subjective approach

A subjective approach dictates that the taxpayer’s intention before, during and after business transactions have to be considered by SARS when making a calculation on the amount received/accrued for gross income purposes.⁶ A taxpayer’s intention according to the subjective approach is a reflection of the true characteristics of the transaction.⁷ The test adopts the view that when a taxpayer receives an amount in a year of assessment for him or herself without an accompanying benefit, he or she will not be liable for tax. Benefit is an important factor in the test for determining taxable income.

1.3 The Objective approach

The second approach to determining taxable income is referred to as the objective method. The objective approach bases its findings on surrounding facts⁸ of the case. Presiding officers do not consider the taxpayer’s intention when determining gross income because for them (court), the subjective state of mind of entering into business transactions is legally irrelevant whilst the purpose is vital.⁹

⁵ S B Cohen ‘Does *Brummeria* sweep clean? A US Tax- Law Perspective’ 2.

⁶ T Spearman *Valuation of amounts for the purpose of inclusion in gross income* (unpublished LLM thesis, Rhodes University, 2011) 22.

⁷ P Haupt *Notes on South African Income Tax* 34 (2015) ed 45.

⁸ B Madigan, ‘Objective and Subjective value’, available at <http://www.OntarioRealEstateSource.com>, accessed on the 10th November 2016.

⁹ *SIR v Trust Bank of Africa Limited* 37 SATC 87, 105.

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At the core of the approach is ensuring predictable tax outcomes from legislation¹⁰ that are applied consistently to every taxpayer. Interpretation Note 58¹¹ expounds on how the courts should consider the objective approach as a norm in the interpretation of legislation and application in cases.¹² The Note explicitly highlights how the adaptation of the subjective approach had to be reversed for a more strict objective approach,¹³ through the landmark case *Commissioner for South African Revenue Service v Brummeria (Pty) Ltd and others*.¹⁴ An assumption is that there was a need for uniformity where all similarly situated taxpayers had to be taxed equally¹⁵ contrary to treating each taxpayer differently on a case-by-case scenario.

This dissertation will highlight the crucial aspects of the background, evolution as well as the relevance of the valuation debate.

1.4 Aims of the topic

To undertake a comparison of the two approaches as analysed in case law and scholarly writings, in order to demonstrate the difference in the approaches, and to determine which approach should be applied.

1.5 Research question

‘What is the difference between the subjective and objective approaches to valuation, and which should be applied in the South African tax regime as the most practical and fair approach.’

¹⁰ G K Goldswain ‘The purposive Approach to the Interpretation of Fiscal Legislation- the winds of Change’ (2008) 16(2) *Meditari*, 119.

¹¹ Interpretation Note: No. 58 (Issue 2) – 4 October 2012. The *Brummeria* Case and the right to use loan capital interest free.

¹² *Ibid* 2.

¹³ *Ibid* 2.

¹⁴ 69 SATC 205.

¹⁵ R C Williams *Income Tax in South Africa. Cases and Material*. 2 Ed (2005) 102.

1.6 Research Methodology

The dissertation will be conducted through desktop research with reference to the Income Tax Act, the South African Constitution, journal articles, case law, newspaper articles, dissertations, textbooks and other scholarly writings including interpretation notes and legislation. South African sources along with foreign sources shall be consulted as taxation legislation is ultimately influenced by the courts.

1.7 Overview of the chapters

Chapter 2 will discuss how the Courts have hesitated between favouring the subjective and objective method of assessing taxable income, when a benefit is not in cash form. The Income Tax Act does not unfortunately offer a comparison of the various approaches, neither does Interpretation Note No.58.

Chapter 3 will contain an evaluation and comparative critique with reference to the views expressed in *Stander*¹⁶ and other decided cases.

Chapter 4 will explore the ‘equity aspect’ and the goal of consistent treatment of taxpayers.

In addition the possibility of a firm objective taxation system so as to ensure a better balance between the subjective and objective approaches will be discussed in this Chapter.

I will endeavour to propose a conclusion in chapter 5 regarding which approach should be considered the preferred alternative, recalling that at the heart of any taxation system must be the protection of the individual’s rights and adherence to the South African Constitution.¹⁷

¹⁶ *Stander v Commissioner for Inland Revenue* 1997 (3) SA 617 (C), 59 SATC 21.

¹⁷ Constitution of the Republic of South Africa, 1996 (1996 Constitution).

CHAPTER TWO

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2. Introduction

The description of ‘gross income’ as set up in section 1 of the Income Tax Act determines how a taxpayer’s receipts and accruals in cash or otherwise, are assessed for normal taxation purposes. As highlighted in the previous chapter there is a need for valuation of non-cash assets.

Silke¹⁸ notes that ‘if the words cash or otherwise were to be removed from the gross income definition, there would still remain the element of ‘an amount’, which refers to other forms of property earned by the taxpayer¹⁹ with a monetary value’. Traditionally a determination of the asset value for income ‘other than cash’, will be assessed as the amount the asset cost in an open market if it were sold using a reasonable method of sale.²⁰

What follows is a chronological analysis of the case law where the valuation of assets ‘other than cash’ has come before the courts. What is sought is a suitable explanation on the adaptation and implementation of the objective and subjective approach by the courts.

¹⁸A. S Silke and others *Silke on South African Income Tax. Being an Exposition of the Law, Practice and Incidence of Income Tax in South Africa* 10th Ed (2010) 10.

¹⁹ *Lategan v Commissioner for Inland Revenue* 1926 CPD 203, 2 SATC 16.

²⁰ *Lace Proprietary (Pty) Ltd v CIR* 1938 AD 267, 9 SATC 349,362.

2.1 *Lategan v Commissioner for Inland Revenue*

The landmark case²¹ of *Lategan*²² laid the foundation for all valuation cases. The Commissioner for Inland Revenue's (CIR)²³ assessment included an entire amount of £5 924 for wine sold by Willem Lategan as well as funds not yet received to the sum of £2 424. The question before the court was if the amount not yet rewarded had accrued to the taxpayer and if there was an accrual, then how a right to future payment had to be valued.

The Cape Provincial Division of the Supreme Court²⁴ held that Lategan had a right to claim payment of the debt in the near future. This vested right was a right with a monetary value which the taxpayer could turn into cash if he required. The worth of the right was therefore included in *Lategan's* taxable income.²⁵ Watermeyer J was clear that the taxpayer's revenue for taxation purposes²⁶ 'included not only the cash that he had received or which had accrued to him, but the value of every other form of property which he had received or which had accrued to him, including debts and rights of action.'²⁷ Affirming *Booysens*²⁸ case the bench held that 'the rewards which he got might come to him in the form of cash or some other kind of corporeal property or in the form of rights.'²⁹

Lategan embraced the objective approach in determining the value of the right to claim outstanding amounts by a taxpayer and created what would be the famous precedent to academic writing as well as interpretation of the law by courts to this generation.³⁰ In an attempt

²¹ L. van Zyl 'The *Lategan* case: The accrual principle – then and now' 2015 Southern African Business Review Special Edition Tax Stories 98.

²² *Lategan* (note 19 above).

²³ As he was known at the time.

²⁴ In terms of section 86 of Act 41 of 1917.

²⁵ *Lategan* (note 19 above) 18.

²⁶ An affirmation of Gregorowski J in *De Beers Consolidated Mines v Commissioner for Inland Revenue* 1922, W.L.D 184.

²⁷ *Lategan* (note 19 above) 20.

²⁸ *COT v Booysen's Estate Ltd* 1918, A.D 576.

²⁹ *Lategan* (note 19 above) 19.

³⁰ G Jiyane *Received by and accrued to* (unpublished LLM thesis, University of KwaZulu-Natal, 2008) 30.

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to understand the gross income definition in section 6³¹ of the Act,³² Watermeyer J took the intention of the legislature into consideration in interpreting the nature of an amount. The underlying intention of the legislature was to prevent certain taxpayers from escaping taxation³³ on the basis that the value recorded in their assessments were not in cash.

Watermeyer elucidated further through the farmer³⁴ analogy that if a farmer were to receive only farm produce and cattle as the reward of his wits then the worth of property would have to be included in his gross income. One would assume that the judge intended to create a precedent of uniformity amongst taxpayers through the adoption of an objective approach: if a receipt is not in cash then the market value of the receipt is utilised for determining the amount. If a farmer received only farm produce annually not taxing him would mean that he was evading³⁵ taxation merely because he was unable to ascertain cash. Thus the market value of the farm produce would have to be recorded accordingly and taxed objectively.

The interpretation of the Supreme Court was a confirmation³⁶ of Gregorowski J in *De Beers Consolidated Mines*³⁷ that ‘income value is pivotal in taxation and ought to be included where there is ascertainable worth’.³⁸ An essential feature that the *Lategan* judgment mentioned was that an amount will be taxable if the property can be turned into money in a fair market,³⁹ which is an objective test. Objectivity does not question if the taxpayer benefitted from the transaction but seeks to make a determination that property received has monetary worth and can be converted into cash.

³¹ Gross income was defined as ‘the total amount received by or accrued to or in favour of any person other than receipts or accruals of a capital nature, in any year or period assessable under this chapter from any source within the Union or deemed to be within the Union.’

³² The first promulgated Income Tax Act 41 of 1917 of South Africa.

³³ *Lategan* (note 19 above) 19.

³⁴ *Ibid* 18.

³⁵ *Ibid* 19.

³⁶ *Ibid* 19.

³⁷ *De Beers Consolidated Mines* (note 26 above) 184.

³⁸ *Lategan* (note 19 above) 19.

³⁹ *Ibid* 19.

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Lategan's ability to alienate the right of action at any given time aligns with the principles of the objective approach. If a willing buyer is able to purchase the property held by the taxpayer then the amount ordinarily should be gross income. *Lategan* emphasizes the conversion of property: if there is no cash amount, the value should be objectively determined and taxed in terms of the Income Tax Act.

2.2 Ochberg v Commissioner for Inland Revenue

*Ochberg v Commissioner for Inland Revenue*⁴⁰ pertained to shares issued to the taxpayer, Ochberg, by a company for services rendered, and the legal question was whether such shares fell under taxable income. The court had to resolve when an amount is received by or accrues to a taxpayer, and whether it should be evaluated objectively or subjectively.

Ochberg's opposition to the assessment was based on a subjective approach, that he derived no benefit⁴¹ since the shares received were present in his company prior to the transaction so he was no better off⁴² economically than he had been.⁴³ The Supreme Court confirmed Ochberg's contention that the shares had been a receipt which the taxpayer gifted himself. The erroneous judgment was a confirmation of the subjective approach since the taxpayer's intentions during the transactions were taken into consideration along with claims of no benefit. It was argued that the taxpayer did not benefit from the shares received for services rendered so the Supreme Court's assumption was that he derived no benefit due to his existent 100% shareholding was affirmed.

On appeal the Appellant Division took an about turn on the case, finding itself having to deal with all legal issues as if it were the court of first instance. Ochberg's defence that no benefit was derived from the transaction was not accepted by De Villiers C.J.⁴⁴The true form of the

⁴⁰ 1931 AD 215, 5 SATC 93.

⁴¹ *Ochberg* (note 40 above) 97.

⁴² P Haupt (note 7 above) 19.

⁴³ K Coetzee and others '*Ochberg v CIR*: No "benefit" to the benefactor' 2015 Southern African Business Review Special Edition Tax Stories 30.

⁴⁴ *Ochberg* (note 40 above) 99.

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transaction was considered in terms of the Act bearing in mind the nature of gross income. Making an allowance for the aspect of benefit the Judge had this to say:

‘Only in the one case where the receipt is one of a capital nature, only in that case does it not fall within income. In all the other cases the law says it is to be regarded as income. Whether and to what extent the person may have benefited by the receipt of the income is irrelevant, for that cannot alter the nature of the receipt, converting what is income into capital. The amount of benefit may or may not be a good reason for the Legislature to step in and alter the law, but it cannot affect our decision. As long as the law is what it is, the receipt is income and as such liable to income tax.’⁴⁵

The majority decision of the court is vital because it displays the application of the objective approach. De Villiers challenged the minority judgement by pointing out the importance of the reasonable man test. ‘If the same shares had been received by any other person, such receipt would have been income clearly and unmistakably, and could not have been considered as a receipt or an accrual of a capital nature.’⁴⁶ Wessel J.A’s minority judgement made a concession that Ochberg would have paid tax on the shares had he been another person. ‘I admit that if these shares in question had not been issued to Ochberg but to someone else, then such recipient’s estate would have been enriched by the value of the shares and he would have to pay income tax upon such value.’⁴⁷ A reasonable man would have purchased or received the shares at any arm’s length transaction.

Professor Emil Brinker⁴⁸ points out that the substance of the transaction in *Ochberg* was important in jurisprudence because the test was not benefit, but rather the existence of monetary value. The rationale by the court was that if at some point Ochberg had to alienate the shares they would have had value in a third party’s hands hence⁴⁹ the wealth would have to be objectively valued. The taxpayer’s state of mind or intentions did not matter.

⁴⁵ Ibid 97.

⁴⁶ Ibid 97.

⁴⁷ Ibid 112.

⁴⁸E Brincker ‘To which extent is an interest-free loan taxable?’ (2007) available at <https://www.ensafrica.com/newsletter/briefs/taxOct07IntFree.html>, accessed on 01 April 2016.

⁴⁹ Ibid 4.

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The minority judges Stratford JA and Wessels JA erroneously used the subjective test for valuing non-cash receipts. Rejecting the subjective approach from the dissenting judges De Villiers C.J questioned underlying intentions of any taxpayer in concluding a non-profitable business transaction without any prospects of success.⁵⁰ The Judge stated ‘the court need not therefore enquire whether he actually benefited.....of that he is the best judge’⁵¹ as well as ‘what repercussions the receipt of that income may have on the rest of his property does not matter.’⁵²

Not long after *Ochberg*, Schreiner J.A concurred with De Villiers C.J in *CIR v Genn⁵³ & Co (Pty) Ltd* by concluding that, ‘the presence or absence of a benefit to the taxpayer of something that passes into his possession does not provide a proper test in applying the distinction of gross income.’⁵⁴ Essentially *Ochberg*’s principle was that if a taxpayer becomes ‘unconditionally entitled to’ an amount then that receipt is taxable.

2.3 Lace Proprietary Mines (Pty) Ltd v Commissioner for Inland Revenue

The objective approach found favour in *Lace Proprietary Mines Ltd v CIR⁵⁵* where the Appellate Division had two issues to discuss. The first was the preferable approach to adopt when determining gross income,⁵⁶ and secondly, how the value of the share consideration received for mining rights would be determined.⁵⁷

In deciding whether turnover accumulated to the appellant company on the realisation of the mineral rights was income within the meaning of the Income Tax Act⁵⁸ Stratford CJ relied on

⁵⁰ *Ochberg* (note 40 above) 99.

⁵¹ *Ibid* 100.

⁵² *Ibid* 100.

⁵³ *CIR v Genn and Company (Pty) Ltd* 20 SATC 113.

⁵⁴ *Ibid* 123.

⁵⁵ *Lace Proprietary Mines Ltd* (note 20 above).

⁵⁶ The bench’s role boiled down to weighing up the options of what brought about the best results between the objective or subjective approach.

⁵⁷ *Lace Proprietary* (note 20 above) 361.

⁵⁸ 40 of 1925.

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*CIR v Lydenburg Platinum Ltd*⁵⁹ where it was said that intentions of the taxpayer were irrelevant in determining gross income but what counted were the facts of the case.⁶⁰ The Appellate Division concentrated on the taxpayer's actions leading up to the accumulation of shares namely the change of company policy, and the disposal and re-acquisition of shares. An examination of the surrounding factors played a critical role in establishing the purpose of the taxpayer. Evidently the aim of the company was to receive profits from the resale of shares and this was accordingly taxable income as determined by the objective approach.

Lace is a validation of earlier cases like *Lategan* that opted for a realistic objective approach by firstly examining whether any amount existed then valuing that amount according to existing market factors. As indicated above, the objective test scrutinizes surrounding circumstances like time of purchase, holding period, alienation of property and the period between holding of an asset and alienation. *Lace* reinforces *Ochberg*'s strict literal approach to the word 'amount' that incorporates an interpretation of non-monetary assets⁶¹ when considering relevant market value.

2.4 Commissioner for Inland Revenue v Butcher Brothers

*Commissioner for Inland Revenue v Butcher Brothers (Pty) Ltd*⁶² discussed an 'amount'. In adjudicating whether an 'amount' had accrued to the lessor in that tax year by virtue of building improvements to be made by the lessee, the court had to establish a suitable value to attach to the buildings after 50 years. The court held that the Commissioner bore the burden of proof in establishing the presence of an amount in the right to the improvements.⁶³

Feetham J.A stated:

⁵⁹ 1929 AD 147.

⁶⁰ Ibid 359.

⁶¹ T Spearman (note 6 above) 45.

⁶² 1945 AD 301.

⁶³ P Haupt (note 7 above) 19.

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‘The assessment in dispute, made by the Commissioner under section 7(1) (d)⁶⁴ can only be allowed to stand if some ‘amount’ accrued to or was received by the company in the tax year ended 30th June 1935 by virtue of its rights under the building clauses in the lease, and it is essential for the Commissioner, in order to support his assessment to show that some amount has accrued to or been received by the company by virtue of such rights.’⁶⁵

The Court held that the determination of a benefit from the improvements would only be possible at the expiry date of the tenancy. Determination was going to rely on the lease of 50 years with a further option for another period of 49 years. Consequently, it would be impossible to assign any value to such benefit prior to the expiration of the lease. Due to a lack of ascertainable monetary value in that particular tax year, it was impossible to make a decision on an amount in respect of the improvements. According to Williams⁶⁶ *Butcher Brother’s* establishes the rule which was later affirmed in *CIR v People’s Stores (Walvis Bay) (Pty) Ltd*,⁶⁷ that despite the gross income definition, ‘an amount’ can be corporeal or incorporeal property which is earned by the taxpayer.

Butcher Brother’s principle is that there should always be an amount for taxation to take place. If an amount exists then SARS will allocate the value to a specific category like gross income or capital.

2.5 Commissioner for Inland Revenue v Hersov

In *CIR v Hersov*⁶⁸ two company directors (the taxpayers) waived their rights to permanent directorships for a consideration of £6 250 on the date that their contract became binding. An agreement was reached by the company with a director to compensate him for the waiver of certain rights and assenting to vote in favor of a resolution sponsored by the company. In line with the contract the director received remuneration in the form of shares issued to him at a

⁶⁴ Income Tax Act 40 of 1925.

⁶⁵ *Butcher brothers* (note 62 above) 313.

⁶⁶ R C Williams (note 15 above) 82.

⁶⁷ 1990 (2) SA 353 (AD), 52 SATC 9.

⁶⁸ 1952 (1) SA 485 (A), 18 SATC 20.

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price well below the market value. One of the questions in the case was whether the discount was taxable in the hands of the director.

The Appellate Division decided that true consideration for the waiver of the permanent directorships was the right to subscribe for shares. The true characteristic of the waiver was not revenue but capital. In as much as the result was capital the issue of valuation had to be discussed briefly by the court due to the accrual of the amount.⁶⁹ The court stated that the question posed was ‘What a reasonable buyer would have paid for the shares at that time, not knowing how the shares would perform on the market in future.’⁷⁰

An objective approach was adopted by the Appellate Division in using the reasonable or unsophisticated man investigation. The reasonable man test in common law was initially formulated as a measure to try and gauge whether individuals as a collective find a certain item or rule acceptable. The test does not seek to explore the subjective state of mind of a person but rather it investigates whether a person who lacks education and sophistication can find a transaction sound enough for him to enter into.

2.6 Mooi v Secretary for Inland Revenue

Twenty years later in 1972 the issue of how non-monetary assets ought to be valued was again discussed in *Mooi v SIR*.⁷¹ The taxpayer, an employee of Palabora Mining Co Ltd, was offered an option to subscribe 500 of the company’s R1 ordinary shares, at R1,25 per share. The contract gave the taxpayer conditional options upon the taxpayer rendering services to the company at that time, and in the future.⁷² The taxpayer’s assessment included the R2 575, the value of the option, and the dispute boiled down to exact time of accrual and if so at what valuation.

⁶⁹ T S Emslie ‘Clarity at last on the meaning of accrual’ *Derebus*, June 1990, 2.

⁷⁰ *Ibid* 2.

⁷¹ 1972 (1) SA 675 (A), 34 SATC 1.

⁷² *Ibid* 1.

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The taxpayer's dispute against the assessment lay on the premise that the option was only exercisable at a future date when some conditions were complied with. The Appellate Division arrived at its decision using the objective test by scrutinizing the taxpayer's legal entitlement to the amount, instead of his subjective mind specifically the primary intention.

The Appellate Division believed that the accurate and material benefit in the proposal was the right, upon completion of the conditions, to procure shares at the offered rate. Benefit accrued when all the surrounding conditions were satisfied leading to an unqualified entitlement to the sum. In an emphasis, the court pointed out that:

'The tax is to be assessed in money on all receipts or accruals having a money value. If it is something which is not money's worth or cannot be turned into money, it is not regarded as income.'⁷³

An analysis of the facts of the case showed that although the taxpayer signed the contract and received the right to options in 1963, he only became unconditionally entitled to the right in 1966. Relying on *Lategan*, the right in 1963 could not have been turned into money for the following reasons;

1. The right was a mere spes⁷⁴ in the hands of the taxpayer as he could not alienate the options to a third party due to the restrictive conditions in the contract. The options in 1963 were part of a plan meant to retain the taxpayer as an employee for services to be rendered.
2. Since the options were impossible to alienate they were neither enforceable by the taxpayer nor was he unconditionally entitled to the rights.

⁷³ Ibid 683 A-F.

⁷⁴ Ibid 8.

2.7 Commissioner for Inland Revenue v People's Store (Walvis Bay) (Pty) Ltd

The taxpayer in *People's Stores*⁷⁵ was a subsidiary in a group of companies, namely Edgars, which traded as a retailer of clothing. The Commissioner included R341 281 in the taxpayer's gross income constituting of instalments that were not payable by debtors until the subsequent year. The taxpayer's objection rested on the foundation that payments were neither payable, nor were they paid in that current year of assessment so they had to be excluded from gross income for the current year of assessment.

The Appellate Division dealt with two issues, the first being whether the instalments constituted amounts for gross income purposes and secondly what form of valuation had to be adopted.⁷⁶ The court concentrated on cases that had dealt with valuations to date, starting with *Commissioner of Taxes v Booysen's Estate*⁷⁷ which specified that 'income did not always consist of money' and that 'income in a form other than money is always taxable'.⁷⁸ Although income can be termed an amount, 'it need not be an actual amount of money but may be every form of property earned by the taxpayer, whether corporeal or incorporeal, which has monetary value including rights of action debts.'⁷⁹ In *CIR v Delfos*⁸⁰ Wessels CJ stated that 'if an asset is something not money's worth or cannot be turned into money then it cannot be regarded as income.'⁸¹

Hefer J.A emphasized that;

'The first and basic proposition is that income, although expressed as amount in the definition need not be an actual amount of money but may be 'every form of property earned by a taxpayer, whether corporeal or incorporeal, which has a money value including debts and rights of action...'. This proposition is obviously correct... it is hardly conceivable that the legislature could not have been aware of, or would have turned a blind eye to, the handsome profits often

⁷⁵ *People's Stores* (note 67 above).

⁷⁶ *Ibid* 3.

⁷⁷ *Booyesen's Estate* (note 28 above) 576.

⁷⁸ *Peoples Stores* (note 67 above) 16.

⁷⁹ *Lategan* (note 19 above) 207-210.

⁸⁰ 1933 AD 242 at 251.

⁸¹ *Ibid* 251.

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reaped from commercial transactions in which money is not the medium of exchange. Consider e.g the many instances of valuable property changing hands, not for money, but for....*remuneration for services in the form of free or subsidised housing*... These are only a few of the many possible illustrations that readily come to mind and which, as we know, have not been overlooked by the legislature.⁸²

The *People's Stores* decision was restated in *Cactus Investments (Pty) Ltd v Commissioner for Inland Revenue*⁸³ where in the discussion of gross income Hefer J held;

'Includes, as explained in *Commissioner for Inland Revenue v People's Stores Walvis Bay (Pty) Ltd* not only income actually received, but also rights of non-capital nature which accrued during the relevant year and are capable of being valued in money.'⁸⁴

He stated further that,

'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.'⁸⁵

All the above mentioned cases were used in answering the question as to whether the instalments were gross income. Regardless of the instalments not being cash and not having been received they had accrued to the taxpayer unconditionally. The value of instalments had to be included as gross income because it passed all the tests dictated by previous courts. Despite the instalments not being cash, monetary worth existed and upon receipt the instalments could be converted into money. The rights to the instalments was included in the gross income and had to be valued although such valuation would prove problematic due to the unenforceability at that time.⁸⁶

⁸² *People's Stores* (note 67 above) 3631- 364C

⁸³ 1999 (1) SA 315 (SCA) 353 (A).

⁸⁴ Ibid 319 G-H.

⁸⁵ Ibid 320 H.

⁸⁶ *People's Stores* (note 67 above) 32.

2.8 Conclusion

What can be gleaned from the analysis of these cases is that when due to services rendered a taxpayer becomes entitled to an amount, then that amount must have a monetary value allocated to it so as to determine the amount to be included in gross income. Where contracts contain provisions of non-monetary considerations, then the accruing amount is the exact value that ought to be taxed. Emphasis on ‘the value of the property’ means the ‘price that could have been obtained for it, on the date of accrual, by adopting some reasonable method of sale on that date’.⁸⁷

Whether an objective or subjective approach is adopted has a significant impact on ascertaining the monetary worth of property received by barter and exchange transactions, since the property received by or accrued to a taxpayer does not occur in a cash form. Where an asset is exchanged for another asset the value of the new asset constitutes an amount that has been ‘received’, or that has ‘accrued’ to taxpayer. The value will be taxable if it is determined that the old asset was not of a capital nature, the test being whether the amount is received by or it has accrued to the taxpayer. Silke emphasizes that barter or exchange transactions are incorporated in the gross income definition if it can be presented that the old asset that has been exchanged formed part of trading stock, and the asset constitutes an amount received with a monetary value.

The ensuing chapter will focus on the principal case dealing with the subjective approach which defied the court’s interpretation of the valuation of an amount for the purposes of gross income in previous cases. Facts and law in *Stander*⁸⁸ will be discussed along with the condemnation from scholars as well as judges in cases that were to follow.

⁸⁷ *Lace Proprietary Ltd* (note 20 above) 392.

⁸⁸ *Stander* (note 16 above).

CHAPTER THREE

AN EVALUATION AND COMPARATIVE CRITIQUE UNDERTAKEN WITH REFERENCE TO STANDER AND THE VIEWS EXPRESSED BY AUTHORS IN DECIDED CASES

3. Introduction

As an extension of the preceding chapters that discussed the cases that laid a foundation to determine what an amount is, the valuation of property for gross income and the varying approaches, this chapter will offer an analysis of a landmark case that followed the subjective approach. What is astounding is how the courts made an error in law which till today, few tax experts understand. A discussion of *Stander*⁸⁹ will be first be laid out, then an analysis of how and why the decision was incorrect specifically in relation to the doctrine of judicial precedence will follow.

3.1 *Stander v Commissioner for Inland Revenue*

Stander is a highly influential case because it not only highlights how an amount can be included or excluded from a taxpayers gross income though the subjective test, but it is one of the few cases that has endeavoured to explain the true nature of the subject approach. Despite being erroneous in law the judgment remains significant since it has neither been challenged in any court nor has it been overturned. Although *Stander* covered several issues, only the features relevant to this dissertation will be discussed. These are whether the amount received by the taxpayer constituted an amount to be included in gross income and if so whether the subjective test was the appropriate assessment to employ to determine this.

⁸⁹ Ibid 90.

3.1.1 Facts

Delta Motor Corporation (Pty) Ltd was a manufacturer and distributor of motor vehicles and Frank Vos Motors was one of their franchise dealers responsible for the preparation of periodic financial reports.⁹⁰ Stander (the taxpayer) was secretary/ bookkeeper employed by Frank Vos Motors, who prepared financial reports for Delta. The taxpayer was awarded a prize comprising of a seven day overseas holiday for him and his wife with a value of R14 000 encompassing air fares and accommodation by Delta⁹¹ for his outstanding performance in financial management.⁹² The winners were neither permitted to take cash as an alternative to the prize nor could they transfer the prize to any other individual.⁹³

In 1990 the taxpayer filed his income tax returns without the R14 000 award and to his dismay the Commissioner's revision of the returns included the amount according to section 1⁹⁴ of the Act. The Cape Provincial Division⁹⁵ applied a checklist to determine the taxability of the contentious amount. Firstly it had to be determined if the award was a fringe benefit⁹⁶ under paragraph (i)⁹⁷ since the amount was for services rendered. Stander was neither an employee

⁹⁰ Ibid 215

⁹¹ Ibid 215.

⁹² Ibid 213

⁹³ Ibid 218.

⁹⁴ **gross income**, in relation to any year or period of assessment means;

‘in the case of any person, the total amount, in cash or otherwise, received by or accrued to or in favour of such person during such year or period of assessment from a source within or deemed to be within the Republic, excluding receipts or accruals of a capital nature, but including, without in any way limiting the scope of this definition, such amounts (whether of a capital nature or not) so received or accrued as are described hereunder.’

⁹⁵ Taxpayer appealed to the Cape Special Court for Hearing Income Tax Appeals against the Commissioner's decision to disallow taxpayer's objection. Appeal was dismissed hence it was heard at the Cape Provincial Division.

⁹⁶ Extra benefits other than salaries or wages received by employees from their respective employers during the course of their employment for example a company car.

⁹⁷ ‘The cash equivalent, as determined under the provisions of the Seventh Schedule, of the value during the year of assessment of any benefit or advantage granted in respect of employment or to the holder of any office, being a taxable benefit as defined in the said schedule...’.

nor an independent contractor to Delta thus he could not be taxed under paragraph (i). Had the trip been issued by Frank Vos Motors his employer, the amount would have been levied.

Conradie J held that Stander was not liable for the R14 000⁹⁸ as it was not a taxable benefit since he did not receive any property since the trip and the property was not convertible into money.⁹⁹

3.1.2 The Law

In arriving at the decision the court followed a few steps which have to be mentioned. The first question posed by the bench was the meaning of an amount and Friedman J began by analysing *Lategan*. Going through Watermeyer J's decision it was seen that;

‘Income was what a person earned by his work or his wits or by the employment of his capital and that the rewards which such person gets may be in the form of cash or some other kind of corporeal property or in the form of rights.’¹⁰⁰

Watermeyer J went further to explain that the ‘word amount must be given a wider meaning and must include not only money but the value of every form of property earned by the taxpayer, whether corporeal or incorporeal, which has a money value.’¹⁰¹

When it was determined that an amount did exist the court had to ascertain the value of that amount. Friedman J stated that the receipt of the holiday trip could not be taxed as because it could not be turned into money, and it did not have money's worth.¹⁰² Accordingly there was no amount to include in gross income.

⁹⁸ *Stander* (note 16 above) 215.

⁹⁹ *Ibid* 215.

¹⁰⁰ *Lategan* (note 19 above) 208.

¹⁰¹ *Ibid* 209-209.

¹⁰² *Stander* (note 16 above) 219.

3.2 Criticism of *Stander*

3.2.1 The Convertibility principle

For an amount to be subject to normal tax it ought to be in cash form or have a value in cases of rights/property as well as conform to the principle of convertibility.¹⁰³ *Stander* was erroneous in law due to the courts assumption that the holiday could not have been exchanged or sold to a third party due to the terms of the contract. The stringent interpretation of an amount and case law in *Stander* is highly problematic.

Friedman J based his judgment on a strict and literal approach, adapting Wessels J's ratio decidendi in *Delfos*¹⁰⁴ in support of his judgment. This principle was that 'if property cannot be turned into money then it cannot be regarded as gross income.'¹⁰⁵ This strict approach was a restrictive application on the holiday amount received by the taxpayer directly contradicting provisions in *People's Stores*¹⁰⁶ that the word 'amount' must not be interpreted and applied strictly. *ITC 701*¹⁰⁷ stresses that a restrictive approach to amounts should not be adopted. The court a quo in *Stander* adopted the provisions in *ITC 701* and emphasized that 'value of a benefit received, which anyone who availed himself of the service would have paid, will be the amount included as gross income.'¹⁰⁸ The focal point is what a consumer of the service would have had to pay had he not been given property for nothing. The *Stander* appeal court ought to have posed the question as to what a third party would have paid for the holiday received by *Stander* at an arm's length transaction.

The reasoning of Conradie J's judgment in *ITC 701* was upheld and found to be correct¹⁰⁹ by Hefer JA in *Peoples Stores*:

¹⁰³ Taxpayer should be able to alienate the assets or convert property into cash. If the property cannot be converted into cash then it ought to have a monetary value according to the market rate.

¹⁰⁴ *Delfos* (note 80 above) 242.

¹⁰⁵ *Stander* (note 16 above) 217.

¹⁰⁶ *People's Stores* (note 67 above) 3631- 364 C.

¹⁰⁷ (1950) 17 SATC 108.

¹⁰⁸ *Ibid* 623 C-I.

¹⁰⁹ The judgment which was rejected in *Stander*.

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‘It is hardly conceivable that the legislature could not have been aware of, or would have turned a blind eye to, the handsome profits often reaped from commercial transactions in which money is not the medium of exchange. Consider for example, the many instances of valuable property changing hands, not for money, but for shares in public or private companies; or share cropping’s agreements, dividends in the form of bonus shares, or remuneration for services in the form of free or subsidized housing and the use of motor vehicles. These are only a few of the many possible illustrations that readily come to mind.’¹¹⁰

Watermeyer in *Lategan* proceeded to clarify that ‘Income need not be a sum in monetary terms only. Since income is produced through the employment of capital and intellect, the incentive earned subsequently may be cash or some other kind of corporeal property or in the form of rights.’¹¹¹ Essentially *Lategan*’s decision that ‘an amount will be taxable if the property can be turned into money in a fair market’, is an objective test. Objectivity determines if property received had/has monetary worth and can be converted into cash if need be.

In *Lace Proprietary Mines Ltd* it was concluded that amounts received not in cash form should be established by ascertaining the market value of the taxpayer’s right, at the date the taxpayer became entitled to the asset received.¹¹² Hefer J in *Peoples Stores*¹¹³ confirmed founding principles in *Lategan* that ‘Every form of property earned by the taxpayer, whether corporeal or incorporeal which has a monetary value including debts and rights of action must be included as gross income’.¹¹⁴

*Tennant v Smith*¹¹⁵ involved a taxpayer employed as an agent of the Bank of Scotland who apart from salary received, occupied a house owned by his employer (the bank). The issue was whether the rental value of a bank-owned house was income in a taxpayer’s hands. *Tennant*’s ‘convertibility principle’ held that if substantial things of money value are capable of being

¹¹⁰ *Peoples Stores* (note 67 above) 209.

¹¹¹ *Ibid* 209.

¹¹² *Lace Proprietary* (note 20 above) 359.

¹¹³ *Peoples Stores* (note 67 above) 6.

¹¹⁴ *Lategan* (note 19 above) 209.

¹¹⁵ 1892 AC 150.

turned into money, they might for that purpose represent money's worth and are therefore taxable. Halsbury LC's words were as follows:

'Mr Tennant occupies this house without paying rent for it. It may be conceded that if he did not occupy it under his contract with the bank rent free, he would be obliged to hire a house elsewhere, pay rent for it, and pro *tanto diminish* his income. And if any words could be found in the statute which provided that besides paying income tax on income, people should pay for advantages or emoluments in its widest sense, there is no doubt of Mr Tennant's possession of material advantage, which makes his salary of higher value to him.'¹¹⁶

The English law 'convertibility principle' was adopted and still applies to this day in South Africa. In common law an 'amount is not income if the taxpayer cannot convert it into money'¹¹⁷ and cases like *Delfos*, *People's Stores* as well as *Lategan* extend on the principle. If the taxpayer cannot convert the property but its economic value can be ascertained on the market then the value is taxable. Legislation too confirms the 'convertibility principle' in section 1 of the Act, it is implied that the gross income definition means 'an actual amount of money may be every form of property earned by the taxpayer, whether corporeal or incorporeal, which has a money value.'¹¹⁸ It is imperative that Friedman J ought to have considered the convertibility principle in the decision about *Stander* and the trip.

3.2.2 Benefit for gross income

'Benefit' is an accurate determinant of whether amounts should be included in gross income. Authors like Haupt¹¹⁹ affirm that an amount will be deemed to be received by the taxpayer if it is for his own benefit or on his behalf. The aim of this section is to highlight that *Stander* did benefit from the trip hence the amount was taxable. If the taxpayer benefitted in a transaction the objective approach based on a consideration of the facts should be applied by the courts, not considering the taxpayer's state of mind.

¹¹⁶ Ibid 115.

¹¹⁷ *Delfos* (note 80 above) 251.

¹¹⁸ Watermeyer J in *Lategan* (note 19 above) 209.

¹¹⁹ Haupt (note 7 above) 20.

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The majority judgment in *Ochberg* established that benefit to a taxpayer is not the conventional method of valuing the worth of any receipt but it will be applied by the courts. Shares allotted in *Ochberg* were taxable in the hands of the majority shareholder (the taxpayer) and Watermeyer J held that the new shares received by the taxpayer were for his benefit only and no one else thus the value had to be taxed. Essentially where one benefits from a certain transaction even by a few shares or rands the mere receipt or accrual is pivotal. Physical receipt or an accrual will be the determinant, Stander's physical receipt of the holiday was the indication that an amount existed which was susceptible to taxation.

In *Geldenhuis v CIR*¹²⁰ the widow had a usufructuary interest¹²¹ in the flock of sheep she alienated. The 'true' owners of the sheep were her children who were the *bare dominium*¹²² holders as regulated by succession law. Upon enquiry as to Geldenhuis' tax liability the court held that the amount was 'received' by the bare dominium holders hence they benefited from the sale and not the widow. Herbststein A.J in *Geldenhuis* did emphasize that one will only have an amount included in gross income where they are unconditionally entitled and truly benefit from the property and can utilise the cash received as they please. Legality or intention should not be central to the study of amount receipts but the court will concentrate on significant surrounding facts¹²³ like when the property was bought, the holding period, nature of the sale and/or method of payments.

In deciding whether deposits received by a manufacturer for purchased bottles had accrued as taxable income the court answered in the affirmative in *Brooks Lemos*¹²⁴ by utilizing the 'benefit theory'. It was alleged that the deposits became the absolute property of the manufacturers because they could utilise the amounts however and whenever they wanted, and thus they (the manufacturers) were liable to tax. The holiday became the absolute property of Stander from which he benefited along with his wife. He had a real right in relation to the trip. Had Delta revoked the trip after rewarding Stander then the taxpayer would have had some

¹²⁰ *Geldenhuis* 1947 CPD.

¹²¹ The legal right to temporary use and income. Right to benefit from someone else's property.

¹²² The ownership of a thing without the right of use.

¹²³ *Lydenburg Platinum* (note 59 above) 359.

¹²⁴ 1977 (2) SA 976 (A).

form of contractual resolution to either claim an amount of money or an equivalent of the award.

All the above mentioned factors have highlighted why the analysis was erroneous in law, not only did the court fail to take into consideration the true nature of the facts but it also adopted an impractical approach. The following case study will highlight why the courts have crossed over to the objective approach when interpreting cases of amount valuation.

3.3 Commissioner for South African Revenue Service v Brummeria (Pty) Ltd and others

Brummeria is a distinctive illustration of why the decision in *Stander* was incorrect and why the objective approach is by far the most practical approach. For purposes of this dissertation the contention is not whether the loan capital received by the companies is a receipt for gross income. It has already been established in the law of taxation that a taxpayer does not enjoy full ownership of a loan since he faces obligations to pay back the amount.¹²⁵

The discussion lies solely on whether the benefit consisting of the right to use loans without paying any interest constituted an ‘amount’ which had an ascertainable money value and was rightfully included in the taxpayers gross income. Ensuing paragraphs will explore all the elements that have to be met for an amount to be included in gross income.

3.3.1 The Law

Taxpayers (three companies) in this case were in the business of developing retirement villages and in this instance contracted with would-be residents of units to be construed in the retirement villages.¹²⁶ According to the contract, a loan to finance the construction of a unit in a retirement village would be distributed to the taxpaying companies. The loan would be repaid by the

¹²⁵ *Commissioner for Inland Revenue v Genn & Co (Pty) Ltd* 1995 (3) SA 293 (A) 301 B-G. *Commissioner for Inland Revenue v Felix Schuh (SA) (Pty) Ltd* 1994 (2) SA 801 (A) 821 D-G.

¹²⁶ *Brummeria* (note 14 above) 3.

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taxpayer upon cancellation of the contract, or upon the lender/ retiree's death.¹²⁷ SARS had to determine whether the right not to pay interest on the loan amounted to gross income in the companies hands.

The taxpayer companies objected to the Commissioner's assessment, on the basis that interest free loans did not result in any amounts having accrued to or being received by the taxpayers as contemplated by the definition of gross income. They argued that these amounts were capital in nature.¹²⁸ The second contention was that the rights could not be turned into money and therefore could not fall within the domain of the decision in *People's Stores*.¹²⁹

The fundamental question was whether a borrower of money under an interest free loan can be taxed on the 'benefit' of not having to pay interest.¹³⁰ *Brummeria's* judgment is a diversion from what was decided in *Stander*,¹³¹ with core principles formulated on the question of whether an asset that cannot be converted into cash will have a value as alleged by the company taxpayers.

Cloete J in leading the judgment of *Brummeria* referred to the court a quo, reported as *ITC 1791*¹³² where *Cactus Investments*¹³³ was used to elaborate on the definition of gross income;

'includes, as explained in *Commissioner for Inland Revenue Services v People's Stores (Walvis Bay) (Pty) Ltd* 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.'¹³⁴

¹²⁷ Clause 8.4 of the contract (cited in paragraph 3 of the Tax Court judgment) repayment of the loan was subject to 'voorwaardes' contained in another clause, the latter clause not being reproduced in the judgment. In absence of further information the assumption is that the obligation to repay was unconditional (as was assumed by the Tax Court and the SCA).

¹²⁸ *Brummeria* (note 14 above) 10.

¹²⁹ *Ibid* 18.

¹³⁰ E Jansen van Rensburg "Commissioner, South African Revenue Service v *Brummeria Renaissance (Pty) Ltd and others: does the judgment benefit an understanding of the concept "amount"?* 2008 Stell L R 34. Accessed on 24 October 2016.

¹³¹ T Spearman (note 6 above) 60.

¹³² 67 SATC 230.

¹³³ 1999 (1) SA 315 (SCA)

¹³⁴ *People's Stores* (note 67 above) 319 G-H.

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He also stated that;

‘the judgment in the *People’s Stores* tells us that no more is required for an accrual than that the person concerned has become entitled to the right in question.’¹³⁵

Lategan’s famous statement that ‘income is produced through the employment of capital and intellect. The incentive that is subsequently earned may be cash or may be in a form or some other kind of corporeal property or in the form of rights’¹³⁶ were used to highlight the importance of the right received by the taxpayers. Cloete J used this precedent to highlight the imprecision found in *Stander* in assuming that inability to convert property to money equates to lack of value. The court held that the value of the *quid pro quo* given to the life-right holders had to be determined along with the right to be exempt from paying interest, then included in gross income after valuation.

Stander was considered in *Brummeria* since counsel for the companies relied on *Stander* to support their argument that the right not to pay interest could not be turned into money by the companies.¹³⁷ The Supreme Court decision clarified that the company’s rights were valuable and stated:

‘...that the question whether a receipt or accrual in a form other than money has a money value is the primary question and the question whether such receipt or accrual can be turned into money is but one of the ways in which it can be determined whether or not this is the case, in other words, it does not follow that if a receipt or accrual cannot be turned into money, it has no money value. The test is objective, not subjective. It is for that reason that the passages quoted from *Stander* case incorrectly reflect the law and the reasoning of Conradie J in ITC 701 was correct. The question cannot be whether an individual is in a position to turn a receipt or accrual into money.’¹³⁸

Interpretation Note 58¹³⁹ was released straight after *Brummeria*. It was intended to serve as a guideline for SARS in clarifying which approach is ideal in valuing amounts. The Note ensures

¹³⁵ Ibid 320H.

¹³⁶ *Lategan* (note 19 above) 209.

¹³⁷ *Brummeria* (note 14 above) 13.

¹³⁸ Ibid 15.

¹³⁹ Interpretation note 58 (note 11 above).

consistency in all valuation cases unlike the previous position where some court judgments subscribed to the objective approach and others like *Stander* finding the subjective approach more practical. In explaining *Brummeria* the Note points out that the SCA found the objective approach to be a more suitable approach and inability to alienate or turn a right into money does not mean that there will not be an ascertainable monetary value.¹⁴⁰ Receipts or accruals that cannot be turned into money will have an ascertainable value if the market value can be determined.

3.4 Conclusion

It cannot be denied that *Stander* played a pivotal role in taxation by leading the discussion about the two approaches in amount valuation for the levying of gross income. Unfortunately not only does it contradict with case law developed over a period of years which followed for the objective approach by adopting guiding principles from *Lategan*, *Ochberg*, *Peoples Stores* along with *Tennath v Smith*. Every court may exercise its discretion in interpreting and applying legislation but there must be a level of consistency, where previous decisions are utilised as a rubric as recommended by the doctrine of judicial precedent. *Brummeria* highlights that the test in determining amounts is objectivity and not subjectivity,¹⁴¹ an affirmation of previous cases.

The ensuing chapter will firstly elucidate each approach to amount valuation then highlight the preferred approach by the author. Principles like fairness and equality are vital in Constitutional societies and it ought to be reflected in the tax system through policy making by SARS and the legislature.

¹⁴⁰ Ibid 2.

¹⁴¹ Ibid 3.

CHAPTER FOUR

THE POSSIBILITY OF A FIRM AND OBJECTIVE TAXATION SYSTEM SO AS TO ENSURE A BETTER BALANCE BETWEEN THE TWO APPROACHES

4. Introduction

For time immemorial taxpayers have resented the tax system for depriving them of their hard earned money and it has led to the imperative that governments create tax systems that are functional, fair and just to persuade taxpayers to pay their dues. It has been said after all that ‘justice should not only be done but should be seen to be done.’¹⁴² This chapter seeks to expand on both the subjective and objective approach to the valuation of amounts for the purpose of gross income, showing the advantages as well as the disadvantages of both approaches in light of the above principles.

Rules of taxation dictate that amounts received by taxpayers are either capital or revenue in nature and an exact value of amounts should be determined then the taxpayer will be taxed accordingly. I will explain why the objective approach is the best preference for tax systems as a whole, given its core values like equity and justice. The following discussion takes into cognisance how tax regimes have evolved over the years, from mere tax collection to tax on development aimed at social and economic stability.¹⁴³

¹⁴² D. J Brynard ‘Reasons for administrative action: What are the implications for Public Officials’ (2009) 44 (3.1) *Journal of Public Administration* 646.

¹⁴³ G K Goldswain ‘The purposive approach to the Interpretation of fiscal legislation- the winds of change’ (2008) 16 (2) *Meditari Accounting Research* 107-121.

4.1 Subjective approach

The subjective approach is based on the premise that any investigation of amounts received or accrued to the taxpayer should lead to an inquiry into the taxpayer's state of mind¹⁴⁴ during that receipt or accrual. Haupt¹⁴⁵ notes that 'the dominant intention with which the taxpayer acquires an asset determines whether the amount is capital or revenue'. The subjective approach has been an effective investigative tool in differentiating between capital and revenue. The intention of companies will be established through commercial activities such as resolutions by the members¹⁴⁶ and the actions of directors.¹⁴⁷ Unlike a company, natural persons are questioned on their intentions at the beginning, during and after the business activities. Upon the taxpayer's inquisition the response that he gives¹⁴⁸ will be considered by the authority concerned and great reliance¹⁴⁹ will be placed on the evidence lest facts show otherwise.

When the taxpayer's intentions have been examined, the subjective approach further dictates that there must be an existence of financial benefit to the taxpayer before the amount can be included in gross income. Benefit¹⁵⁰ along with an intention to receive the amount are conclusive that the taxpayer became entitled to the amount.

Unfortunately establishing any taxpayer's state of mind either through interrogations or fact finding is a complex if not an impossible task. Kabot¹⁵¹ highlights that a taxpayer's intention is never easy to establish regardless of any apparent honesty, because motives are undetectable. What Kabot could have meant was that economic transactions should not only be scrutinised on face value because of the inability to determine a taxpayer's intention. Surrounding

¹⁴⁴ *Lydenburg Platinum Ltd* (note 59 above) 147.

¹⁴⁵ Haupt (note 7 above) 45.

¹⁴⁶ *Ibid* 46.

¹⁴⁷ *CIR v Richmond Estates (Pty) Ltd* (1950 AD).

¹⁴⁸ Taxpayer's response is also referred to as his *ipse dixit*.

¹⁴⁹ *Malan v KBI* 1983, AD, 45 SATC 59.

¹⁵⁰ *Geldenhuys* (note 123 above) 266; *Commissioner of Taxes v G* 1981 (4) SA 167 (ZAD) at 168 D-F; *Commissioner for Inland Revenue v Genn & Co* (note 53 above) 301F.

¹⁵¹ G Kabot *Purpose and Effect: The Role of a Taxpayers Intention in Tax Legislation* (unpublished MComm thesis, University of Cape Town, 2012) 35.

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circumstances ought to be established such as through what medium an asset was acquired, the holding period, type of alienation and the quantities of assets at alienation. If a taxpayer purchased a piece of land, attempted to farm but dismally failed then decided to sell the land the court would easily be able to determine that the land sold was capital and it was not treated as income. The scenario would differ where land is purchased and alienated within a very short period of time, subdivided into smaller pieces to generate profit.

The Appellant Division in *SIR v Trust Bank of Africa Ltd*,¹⁵² through Botha JA, discussed intention in length. The presiding officer stated:

‘In an enquiry as to the intention with which a transaction was entered into for the purpose of the law relating to income tax, a court is not concerned with that kind of subjective state of mind required for the purposes of criminal law, but rather with the purpose for which the transaction was entered into.’¹⁵³

Evidently it is virtually impossible to determine the intentions of taxpayers, especially where the person is a juristic body. The subjective approach makes it difficult to treat similar taxpayers alike due to various interpretations by judicial officers. Unlike criminal law where the intention of a person is easily determined through a person’s deliberate action of appropriating a neighbour’s car then selling it to a known illegal car dealer, tax law varies. To find the slightest sign of intention or state of mind, one would have to scrutinize a chain of events which could take months or years.

Care must be taken not to down play the role that the subjective approach has played to date. It has enabled judicial officers and SARS to differentiate between capital and revenue amounts. Differentiating between capital and revenue is vital because it allows SARS to include amounts of a revenue nature in gross income, and exclude capital amounts. In a similar manner SARS utilizes essentially the same tests to determine the valuation of amounts and what can be included in gross income. Originating from *CIR v Stott*¹⁵⁴ the discussion between revenue and

¹⁵² *Trust Bank of Africa Ltd* (note 9 above).

¹⁵³ *Ibid* 252.

¹⁵⁴ 1928 AD 252 at 264, 3 SATC 261-62.

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capital was said to lie solely on the importance of intention. Wessels J.A, commenting on the dominant intention test said:

‘... It is sufficient to say that intention is an important factor and unless some other factor intervenes to show that when the article was sold in pursuance of a scheme of profit-making, it is conclusive in determining whether it is capital or gross income.’¹⁵⁵

The subjective approach has also found use in determining the taxability of illegal amounts. The starting point for a court is when an illegal amount became beneficial to the taxpayer?¹⁵⁶ If there is benefit to the taxpayer, the court will enquire further. Classen¹⁵⁷ explains that in such cases the court will pose two questions in determining the nature of the amount, the first being ‘who has or had use of the money’ then secondly ‘who derived benefit from the amount’. If it is established that the taxpayer utilised the money and he derived a benefit then he will be deemed to have received an amount to be included in gross income.

In *MP Finance Group*¹⁵⁸ the Supreme Court of Appeal held that ‘the essential element of a receipt is the intention of the taxpayer to hold an amount with the purpose of deriving a benefit for himself. In other words, a person receives an amount if he claims a right to it, regardless of whether he is entitled to it or not.’¹⁵⁹ This leading case in illegal receipts dealt with a thief whom the Appeal Court found to be liable for tax since stealing was his income earning activity.¹⁶⁰

In support of the subjective approach E Muller clarifies that;

‘by following the subjective approach all income derived from illegal activities will fall into the tax net if the taxpayer intends to benefit from proceeds except where the taxpayer received the income as an agent (in the broad sense) on behalf of another. This approach will also be

¹⁵⁵ *Stott* (note 154 above) 261-262.

¹⁵⁶ N H Khumalo *The taxability of income derived from illegal activities in terms of the Income Tax Act 58 of 1962* (unpublished LLM thesis, University of KwaZulu-Natal, 2015) 23.

¹⁵⁷ L C Classen (note 68 above) 23.

¹⁵⁸ *MP Finance CC (In Liquidation) v Commissioner, South African Revenue Service* 2007 (5) SA 521 (SCA).

¹⁵⁹ E W Chawira *Taxation of illegal schemes: - should the term ‘received by’ in the definition of gross income be interpreted with reference to the taxpayer’s subjective intention?* (Unpublished LLM thesis, University of Pretoria 2011) 21.

¹⁶⁰ *M P Finance* (note 158 above).

consistent with public policy. Surely it is not in the interest of public policy that a trader who cheats his customers in the course of his business should be subject to income tax while one who actually steals from them should enjoy exemption from tax. If the subjective approach was followed in *COT v G*¹⁶¹ the court may well have found that the thief indeed received the stolen property.¹⁶²

The main reason for adopting the subjective approach in illegal transactions is to ensure equality between all taxpayers seeing taxpayers involved in scandalous transactions are deemed not taxable as they will not have ‘received’ an amount in terms of the definition of gross income.

4.1.1 Subjectivity through the taxpayer’s state of mind

Advocate Broomberg¹⁶³ explains that for the court to establish the nature of an amount there are three forms of taxpayer ‘state of minds’ that have to be deliberated upon namely intention, motive and contemplation.¹⁶⁴ The state of mind is the indicator of what the taxpayer wanted to do. Intention comprises of the action of purchasing an asset so as to alienate it. Motive is/are the reasons for acquiring the asset so as to alienate the property for profits.¹⁶⁵

‘Intention’ is the first port of call made by SARS Investigation which borders on whether the taxpayer wanted to alienate the asset for a profit or not. This by far is the most crucial yet difficult stage to investigate, because one has to make an attempt in establishing taxpayer’s intention at the time of acquisition.¹⁶⁶ Since the intention is undoubtedly subjective only the taxpayer will be aware of the true objectives. SARS would have to apply in depth investigations to establish the intention since there usually is no paper trail to show any tangible evidence.

¹⁶¹ *Commissioner of Taxes v G* (note 150 above).

¹⁶² E Muller ‘The taxation of illegal receipts. A pyramid of problems! A discussion on *ITC 1789* (Income Tax Court- Natal)’ (2007) 28 (1) 177.

¹⁶³ Broomberg ‘Capital vs Revenue’ (1998) 12 Tax Planning 69.

¹⁶⁴ T C Beck *A critical analysis of gross income* (published Masters in Cost and Management Accounting thesis, Nelson Mandela Metropolitan University, 2008) 58.

¹⁶⁵ Broomberg (note 163 above) 69.

¹⁶⁶ T C Beck (note 164 above) 57.

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‘Motive’ is the intention put into action.¹⁶⁷ Taxpayers will apply their intentions to the business transactions by either attempting to make a profit or merely selling their assets for capital. Most of the investigations can be carried out by SARS at this stage because of the evidence from purchase of assets as well as the sale.

In ‘contemplation’ the taxpayer lacks the desire to make any profits from the asset or its alienation.¹⁶⁸ Despite realising possible avenues of making very large profits the taxpayer reconciles with that fact and continues to alienate property as a capital asset. An example would be a farmer who decides to alienate his land without subdividing. He realises that he could have raised greater profits if he had subdivided the land and sold the smaller portions off to several buyers, but for whatever reason he continues to sell the farm as a single portion of land. SARS or the court will, after considering the taxpayer’s state of mind, realise that the amount received was capital due to the lack of profit generation.

These three stages make up the taxpayer’s state of mind that enable SARS to detect the subjective state of mind and true nature of business transactions. One of the difficulties with the subjective approach is found in Becks’ statement originally made in *Stott*¹⁶⁹ that ‘the taxpayer’s intention can change over time and should be investigated at the time the asset was acquired, during the period the asset was held and at the disposal of the asset.’¹⁷⁰

4.2 Objective approach

The objective approach relies on one model that all persons, with the same transactions ought to be treated in the same manner, without introducing exceptions to the general rule. The Commissioner need not look at the taxpayer’s surrounding circumstances that led either to the conclusion of transactions or receipts, but will only consider the very nature of that transaction.

¹⁶⁷ Ibid 58.

¹⁶⁸ Ibid 59.

¹⁶⁹ *Stott* (note 154 above) 260.

¹⁷⁰T C Beck (note 164 above) 59 originally formulated in *Stott*.

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As a result of the demand for uniform rules the objective approach led to the emergence of the horizontal equity¹⁷¹ principle.

Material evidence will be considered rather than the taxpayer's state of mind in the objective stance. Although some subjective factors may seem similar to the objective tests,¹⁷² the latter are distinguishable. Factors that will be considered by the courts in assessing an amount will be continuity, schemes of profit making, reason for the receipt and the legal nature of the asset disposed.

The objective approach thus provides a solution that alleviates any resentment amongst taxpayers, as well as avoiding the economic distortions that lead to unpredictable results. Undisputedly transparency and equality according to Brynard¹⁷³ is 'an important element of democratic public administration because decisions which are shrouded in secrecy lead to suspicion and distrust on the part of the public.'¹⁷⁴

An unequal tax reform system has detrimental political implications on all taxpayers. If certain large corporations, or natural taxpayers with large capital, are exempted or pay very low taxes, then this leads to centralisation of economic power where large corporations continue to accumulate wealth without tax redistribution. Corporations with large monopoly capital inappropriately bully smaller companies, due to their high voting stakes and can alter the rules of the game,¹⁷⁵ directing more wealth and power towards themselves, consequently owning all the means of production.

¹⁷¹ Tax Policy Concept Statement 'Guiding principles for Tax Equity and Fairness'. Issued by the Tax Division of the American Institute of Certified Public Accountants 2007.

¹⁷² T C Beck (note 164 above) 71.

¹⁷³ D J Brynard 'Procedural fairness to the public as an instrument to enhance public administration in public administration' (2011) 19 (4) *Administratio Publica* 112.

¹⁷⁴ Ibid 112.

¹⁷⁵ Ibid 6.

4.2.1 Continuity and schemes of profit-making

Since the need to determine the nature of the transaction arises from time to time, the Revenue Services will consider the continuity of the taxpayer's transactions.¹⁷⁶ Where a taxpayer purchases a piece of land for farming but after several years alienates it due to lack of profits it will be deemed as capital. If however the farmer purchases land, subdivides it into smaller portions and sells it for high profits then the sale of land will be regarded as income. The actions of the taxpayer or in this instant the farmer indicate his business intentions¹⁷⁷ of treating the land as his income generating scheme.

Lord Justice-Clerk in *Californian Copper Syndicate v IR*¹⁷⁸ whilst scrutinizing taxpayers involved in profit making schemes stated; 'The question to be determined being, is the sum of gain that has been made a mere enhancement of value by realising a security, or is it gain made by an operation of business in carrying out a scheme of profit-making.'¹⁷⁹

Continuity and profit making might be the leading tests in the objective approach but there are other factors that SARS will have to take into cognisance when deciding if an amount is capital or revenue. Other significant factors are the manner of acquisition, manner of disposal, period for which the asset was held and the nature of the taxpayer. The objective stance is based on foundations of equality, uniformity, and fairness as will be highlighted below.

4.3 Fairness, equality and horizontal equity

The objective approach is vital within democratic societies as it guarantees equal treatment of taxpayers in similar transaction, which has been defined as horizontal treatment.¹⁸⁰ Section 33(1) of the Constitution states that everyone has the right to administrative action that is lawful, reasonable and procedurally fair. SARS should in collecting revenue should do so in a manner that is consistent with the provisions in the Constitution which aim to promote equality or reasonable discrimination. Administrative action which materially and adversely affects the

¹⁷⁶ Ibid 72.

¹⁷⁷ Ibid 72.

¹⁷⁸ 1904, 41 Sc LR 691, VI SC 894.

¹⁷⁹ T C Beck (see note 164 above) 73.

¹⁸⁰ Horizontal treatment is the equal treatment of all taxpayers in similarly situated situations.

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rights or the legitimate expectations of any person must be procedurally fair¹⁸¹ as stipulated in the Promotion of Administrative Justice Act.¹⁸²

David Elkins,¹⁸³ in an attempt to explain horizontal equity, clarifies that horizontal equity commands that equally positioned taxpayers ought to be faced with similar tax burdens. Where the taxpayer's situations are equivalent then it can be said that a reasonably equal society has been created.¹⁸⁴ Apart from treating similarly situated taxpayers correspondingly, tax rules should clearly specify when the tax is to be paid, how it is to be paid and how the amount to be paid is to be determined. Duncan's¹⁸⁵ article in the TaxBreaks¹⁸⁶ gives a list of what a good tax system should be comprised of. In the list she (Duncan) mentions simplicity, flexibility and above all fairness. One would argue that combining a simple and fair system results in good collections where everyone is willing to comply with set tax rules.

Horizontal equity means that taxpayers in identical situations ought to be taxed alike.¹⁸⁷ Some argue that horizontal equity discriminates against some taxpayers and leads to the decline in economic efficacy and slow economic growth.¹⁸⁸ It has also been argued horizontal equity can lead to unpredictable government wealth distribution, where unlucky taxpayers who fail to get exemptions become the burden bearers of government costs.

Fusfeld explains the United States of America situation in 1986 which saw economic distortions that led to societal inequality as a result of horizontal equity.¹⁸⁹ In the end, taxpayers refused to pay taxes and rebelled against the United States revenue services along with the government. The agitation stemmed from the formation of certain tax 'shelters' comprising of large corporations and rich individuals, who were exempted from paying income tax through

¹⁸¹ Section 3(1).

¹⁸² Act 3 of 2000.

¹⁸³ D Elkins *Horizontal Equity as a Principle of Tax Theory* (2006) Yale Law & Policy Review, Volume 24 Issue 1, Article 3 at 2.

¹⁸⁴ Ibid 2.

¹⁸⁵ F Duncan 'The best are simple, flexible and fair' Moneyweb's TAXBREAKS June 2005 at 2.

¹⁸⁶ Ibid 2.

¹⁸⁷ Tax Policy Concept Statement (note 13 above; 13).

¹⁸⁸ R Fusfeld 'Economics. Principles of political Economy.' 3rd edition at 627

¹⁸⁹ Ibid 627

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the removal of certain receipts (in favour of the shelters) from the gross income definition. Exempted shelters were either allowed not to pay income tax, or they had the option of deferring tax liability to a later year. The transactions equated to a free long-term loan to the shelters from other taxpayers. Instances like these are a typical deterrent model¹⁹⁰ on taxpayers.

Vertical equity¹⁹¹ deals with how tax systems affect different families from the bottom of the income spectrum to the top, from poor to rich. Horizontal equity on the other hand, is the measure whether taxpayers in similar situations e.g. age and family structure are treated in the same manner. An examination of the horizontal equity is pivotal, as it seeks to encourage the public support for the taxation system. Seligman states that ‘The 2011 Policy Brief¹⁹² describes in an example how hard it would be to justify a tax regime that intentionally taxes left handed people more than it does right handed people. In the same manner a tax system should be structured to tax economically equal individuals proportionally, discrimination should be fair based on the varying incomes, facts and business structures of taxpayers.

Karina Coetzee¹⁹³ (quoting Coleman¹⁹⁴) explains what a just, equal and fair society is according to the horizontal aspect:

‘Equality before the law implies that the laws of the state do not recognise distinctions among persons that are irrelevant to the activities of the positions they occupy, but otherwise make no attempt to eliminate inequalities that arise. Equality of result implies a continuous or periodic intervention and redistribution by the State to ensure that the inequalities which arise through day-to-day activities are not accumulated, but are continuously or periodically eliminated.’¹⁹⁵

¹⁹⁰ Scenarios where a taxpayer chooses not to declare and to pay his income tax because of a prejudicial system.

¹⁹¹ Government Accountability Office (GAO) *Understanding the Tax Reform Debate: Background, Criteria and Questions*, GAO-05-1009SP (9/05); <http://www.gao.gov/newitems/d051009sp.pdf>

¹⁹² Institute on Taxation and Economic Policy (ITEP), “Tax Principles: Building Blocks of a Sound Tax System”. Policy Brief, August 2011 available at http://www.ieanea.org/media/2012/02/Tax_principles.pdf accessed on 08 April 2017.

¹⁹³ K Coetzee *Income of Individuals in the Republic of South Africa subsequent to the submission of the Margo Report* (unpublished Phd thesis, University of South Africa, 1995).

¹⁹⁴ Coleman 1987: 169.

¹⁹⁵ K Coetzee (note 193 above) 213.

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Annette Nellen¹⁹⁶ presented a testimony on how proper tax systems should function based on the AICPA¹⁹⁷ Tax Policy Concept Statement 1- *Guiding Principles of Good Tax Policy: A Framework for Evaluating Tax Proposals*. The main aim of the paper was to set out fundamental principles that government's tax reform panels both at state and local level should utilise. Principles of tax systems are a reflection of how taxpayers are treated. The initial AICPA Policy Statement 1 had nine principles that were guidelines of a good tax system amongst the nine listed, the most significant are the following;

1. Equity and fairness- all the similarly situated taxpayers should be taxed similarly¹⁹⁸.
2. Certainty- tax rules should be specific on the dates of payment as well as the mode of such payment.
3. Simplicity- the rules of taxation ought to be simple in order for taxpayers to understand rules and comply with them.
4. Transparency and visibility- taxpayers must know that a tax exists and how, when it is imposed upon them along with others.

Adam Smith's *Wealth of all Nations*¹⁹⁹ emphasizes how taxes ought to be fair within a system, where each person is taxed on his abilities and not an arbitrary amount determined by the tax man. Smith clearly elaborates on an effective tax system,

'The tax which each individual is bound to pay ought to be certain and not arbitrary. The time of payment, manner of payment, the quantity to be paid ought all to be clear and plain to the contributor, and to every other person. The uncertainty of taxation encourages the insolence and favours the corruption of an order of men who are naturally unpopular, even where they are neither insolent nor corrupt. The certainty of what each individual ought to pay is in taxation, a matter of great importance that a very considerable degree of inequality, it appears.

¹⁹⁶A Nellen, Esq CPA 'Policy Approach to Analysing Tax Systems' available at http://www.cob.sjsu.edu/nellen_a/ accessed on 18 April 2017 13:00.

¹⁹⁷ American Institute of Certified Public Accountants.

¹⁹⁸ Joint Committee on Taxation *Description and Analysis of Proposal to Replace the Federal Income Tax*, JS-18-95 accessed on <http://www.house.gov/jct/s-15-18-95.pdf> 58.

¹⁹⁹ A Smith. 'An inquiry into the Nature and Causes of the Wealth of Nations'. (2007) *Digital Library* 638.

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I believe from the experience of all nations, is not near so great an evil as a very small degree of uncertainty.²⁰⁰

In developing Adam Smith's four canons of taxation, the Kaylan City Life blog²⁰¹ offers more cannons that countries ought to adhere to for functional systems. For a fair balance between paying of taxes by civilians and the collection by the Revenue services a system must not be complicated.²⁰² Complicated tax systems makes it difficult to administer policies and to resolve disputes of interpretation.²⁰³

4.4 Conclusion

Irrefutably it is every nation's fantasy to have an ideal tax system that can accommodate all taxpayers and discriminate only on justifiable grounds. Since an ideal tax system is one whose laws are efficient in operation and practicality then the 'cornerstone of all tax programmes should be equality²⁰⁴'. The objective approach creates the ideal system that can undoubtedly satisfy taxation principles set out by institutions like AICPA, which are meant to protect taxpayer's pockets from the Revenue Services and Governments.

²⁰⁰ Ibid 639.

²⁰¹ Kaylan City Life. What is tax- definition- Adam Smith's Canons of Taxation? Accessed at <http://kaylan-city.blogspot.com/2010> on 15 Nov. 17 at 2.

²⁰² Ibid 3.

²⁰³ Ibid 3.

²⁰⁴ E R a Seligman 'The Tax Situation' (1921) 214 *The North American Review* No 789 available at <http://www.jstor.org/stable/2512796>, accessed on 02 March 2017.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS ON WHICH APPROACH SHOULD BE CONSIDERED THE PREFERRED ALTERNATIVE

5. Introduction

Vanya Cohen stated that ‘When there’s a single thief, it is robbery. When there are a thousand thieves, it is taxation’.²⁰⁵ Cohen’s statement is a representation of how thousands of taxpayers have felt for years, with SARS either over taxing or under taxing other taxpayers. Delightfully the South African tax regime has advanced immensely from a system of plain tax collection to fair and strict treatment of the citizens that partake in the taxpaying process annually.

5.1 Taxable amounts

Throughout this dissertation the main focus has been the valuation of amounts, be it subjectively or objectively. For evaluations to occur there is a checklist that has to be followed by SARS, the first being that there must be an amount. An amount which is not capital will be evaluated as already seen in *Butcher Brothers*²⁰⁶ and deemed taxable income if it has some ascertainable value. Should a taxpayer not receive cash it does not mean that they will not be taxed, since an amount can be in cash or otherwise. As long as the non-cash items have a value, they will be included in gross income and subjected to normal tax. *People’s Stores*²⁰⁷ became an affirmation of the previously mentioned case, illustrating the importance of property inclusivity in the avoidance of tax evasion where the asset has some form of value.

After establishing that an amount does exist the next stage is ascertaining the true market value of the property for the levying of gross income. *Lategan* laid down a rule that enabled the courts

²⁰⁵ V Cohen ‘Vanya Cohen: Robbery and Taxation Thieves’ *Made of Money* 8 April 2011, 1.

²⁰⁶ *Butcher Brothers* (note 62 above).

²⁰⁷ *People’s Stores* (note 67 above).

and the Commissioner to make a differentiation of property that has monetary value and property that cannot be categorised as taxable. If a farmer receives only produce the entire year, the produce has to be included in his gross income due to the ascertainable value.²⁰⁸ The *Lategan* judgment clarified that ‘income in its ordinary sense did not always consist of money, unless it was in some form such as a pension or annuity, ‘income’ is what a man earned by his work or his wits or by the employment of his capital. The rewards which he got might come to him in the form of cash or of some other kind of corporeal property or in the form of rights.’²⁰⁹

If the taxpayer derives property from employment that has value then that value will be ascertained using the relevant market rate. A reasonable man test in this dissertation is seen as vital in the investigation of converting property to amounts, a reasonable man is subjected to objectivity and impartiality. Where a taxpayer owns a company and receives shares worth a certain amount the Commissioner will have to determine if a third party would have been taxed on such amount, if so then the taxpayer will be levied on his amounts regardless of the circumstances surrounding the transaction.

ITC 701’s more liberal translation of the reasonable man test is accordingly what a reasonable man would have paid in any standard business transaction, the amount levied for gross income if not capital. A valid question becomes what the taxpayer would have paid for the property had he not received it for free. This leads us to the discussion of *Stander* and how the courts have interpreted receipts and accruals of property with monetary value.

5.2 *Stander* and *Brummeria*

After fulfilling the amount requirement the next stage will be to find the exact value of the property. *Stander*’s receipt of a holiday trip was contentious in a few ways. Firstly, did the value of the trip amount to gross income in the taxpayer’s hands and secondly, whether the ideal approach to valuing the trip was subjective or objective. Friedman J, the presiding officer misinterpreted the *Delfos* judgment which states that where property cannot be ‘turned into

²⁰⁸ *Lategan* (note 19 above) 19.

²⁰⁹ *Ibid* 19.

money' there will be no amount inclusion to gross income. The failure by Stander to turn the trip into money or money's worth²¹⁰ was deemed to be the reason why the holiday was not taxable.

Years later the court, in *Brummeria*, sought to rectify the mistakes made by the Cape Provincial Division in *Standar*. Clarity on the approach to valuations was given by the Supreme Court of Appeal where the objective approach was adopted over the subjective approach that had been preferred by the court in *Standar*. If property cannot be turned into money then the market value will be the amount to be included in gross income, provided that there is a value. The correct judgment would have been that the holiday trip given to Stander was taxable due to its market value that a third party would have purchased for in an arm's length transaction.

5.3 Objective over the subjective approach

For functionality every legal system needs to have rules that are enforceable and uniform not only for taxpayer confidence but to make accountability easy. The dilemma between the subjective and objective approach although finally settled does raise contentious points.

The subjective approach has already been explained in this dissertation, at the root of the approach is the need to treat each taxpayer differently according to their circumstances and to place some importance on the intention of the taxpayer. Intention that SARS would supposedly consider is the state of mind before, during and after the business transaction. A probable argument in support of the approach would be that considering individual situations is fair to the taxpayer because it allows an individual the ability to explain or justify their actions before they incur hefty penalties or unwarranted taxation. In an earlier discussion in this dissertation it was highlighted that during the 'motive' stage the taxpayer puts their plans into action. SARS will have a difficult time determining the taxpayer's state of mind over the lengthy period of time.

²¹⁰ *Standar* (note 16 above) 218.

Unfortunately adopting the subjective approach would not only be impractical but it would vary from the four canons of a good tax system developed by Adam Smith.²¹¹ A good tax system maintains a level of consistency allowing taxpayers the ability to put their finances in order and predict outcomes. Where every taxpayer's intention has to be ascertained before the levying of gross income is impractical because of the lengthy process as well as the demand in more staff. Objective approach remains the fastest and consistent route for all horizontally placed taxpayers.

5.4 Recommendations

Against the backdrop of the discourse presented in the above chapters, I feel that the status quo needs to be maintained. The objective approach must prevail over the subjective approach in the valuation of amounts for inclusion in gross income. Notwithstanding the benefits of the subjective approach, its application in valuation would be burdensome on the already resource-stretched SARS and thus impractical. Determining the intentions of every single taxpayer in every transaction is not a thumb suck activity. For SARS to implement such a policy effectively and efficiently, it would need a hundreds of psychologists to assess taxpayers' intentions, something that is near impossible.

Some taxpayers would argue for fairness by having SARS consider their cases individually but unfortunately this would not only be impractical but expensive as well due to the need for more staff. Tax systems must not only benefit the individual taxpayer but the entire community. In conclusion it is my stance that the objective approach upholds the cannons of taxation that Adam Smith postulated.

²¹¹ Adam Smith (note 199 above).

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08 June 2016

Ms Thandolenkosi Linda Nzima (215080973)
School of Law
Howard College Campus

Dear Ms Nzima,

Protocol reference number: HSS/0737/016M

Project title: An exploration of whether the valuation of amounts for gross income should adopt a subjective or objective approach

In response to your application received on 01 June 2016, the Humanities & Social Sciences Research Ethics Committee has considered the abovementioned application and the protocol have been granted **FULL APPROVAL – No Risk / Exempt Application**.

Any alteration/s to the approved research protocol i.e. Questionnaire/Interview Schedule, Informed Consent Form, Title of the Project, Location of the Study, Research Approach and Methods must be reviewed and approved through the amendment/modification prior to its implementation. In case you have further queries, please quote the above reference number.

PLEASE NOTE: Research data should be securely stored in the discipline/department for a period of 5 years.

The ethical clearance certificate is only valid for a period of 3 years from the date of issue. Thereafter Recertification must be applied for on an annual basis.

I take this opportunity of wishing you everything of the best with your study.

Yours Faithfully

Dr Shenuka Singh (Chair)

/ms

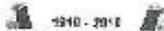
Cc Supervisor: Mr Chris Schembri and Dr Shannon Bosch
Cc Academic Leader Research: Ms S Bhamjee
Cc School Administrator: Mr Pradeep Ramsewak / Ms Robynne Louw

Humanities & Social Sciences Research Ethics Committee
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