



**UNIVERSITY OF  
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**INYUVESI  
YAKWAZULU-NATALI**

**THE TAX IMPLICATIONS OF PROMPT SETTLEMENT DISCOUNT  
OFFERED BY THE SELLER**

by

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## **DECLARATION**

I, Nicholas Vusumuzi Vilakazi, hereby declare that this dissertation is an original piece of work (except where acknowledgements indicate otherwise) which is made available for photocopying and for inter-library loan.

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## CHAPTER 1: INTRODUCTION

### 1.1 INTRODUCTION AND RATIONALE

The prompt settlement discount can be defined as a reduction in the purchase price for early payment granted to a purchaser of goods or services.<sup>1</sup> It allows the taxpayer to pay less than the invoiced amount for goods or services if he makes payment within a defined period. In order to obtain the discount, in most instances, the purchaser will reduce the amount remitted to the seller by the value of the settlement discount offered.

Currently, the treatment of prompt settlement discounts by the buyers and sellers for the purpose of income tax is not consistent and there is insufficient guidance on this issue from the tax authorities.

The courts also differ in their approach to the issue. There has been an ongoing debate concerning the situation where the seller sells goods on credit and offers a discount to purchasers who pay timeously. The question is: what amount accrues to a seller at the financial year-end in respect of those amounts which are unpaid but may still qualify for the settlement discount? Is it the full purchase price that has accrued to the seller or only the discounted price?

In South Africa, in order to decide whether an amount ought to be subject to normal tax, such amount must be regarded as gross income. The definition of gross income provides as follows:<sup>2</sup>

“in relation to any year or period of assessment, in the case of any resident, the total amount in cash or otherwise, received by or accrued to or in favour of such resident, or in the case of any person other than a resident, the total amount in cash or otherwise, received by or accrued to or in favour of such person from a source within or deemed to be within the Republic, during such year or period of assessment, excluding receipts or accruals of capital nature.”

Most of the terms mentioned in the definition of gross income have not been well-clarified by the Income Tax Act. Therefore, the courts have attributed meaning to the definition following the usual process of statutory interpretation.

The legislature has also recognised that a lacuna exists in the tax treatment of transactions which occur over a tax year-end, as the business is taxed on income determined for each tax

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<sup>1</sup> J Arendse 'This is how SARS regards year-end settlement discounts' 2012.

<sup>2</sup> Section 1 of the Income Tax Act 58 of 1962, as amended, "hereinafter the Income Tax Act".

year. This was evidenced by introducing a *proviso* to the definition of gross income. This *proviso* reads as follows:<sup>3</sup>

“provided that where during any year of assessment the taxpayer has become entitled to any amount which is payable on a date or dates falling after the last day of such year, there shall be deemed to have accrued to him during the first-mentioned year of assessment such amount.”

However, reducing the gross income inclusion by the amount of the settlement discount cannot be compared to the situation covered by the *proviso*.

Considering the number of sales agreements that take place in South Africa every year where the settlement discount has been part of the deal, it is surprising to find that there is only one reported case from the Tax Court<sup>4</sup> dealing with determining ‘what amount accrues to a seller as at the end of the tax year in respect of those amounts which are unpaid’.<sup>5</sup> This one case has now been overturned on appeal by the High Court and was later reported as *GUD Holdings (Pty) Ltd v CSARS*.<sup>6</sup>

## 1.2 PROBLEM STATEMENT

This thesis explores the issues of determining what amounts accrues to a taxpayer as at the financial year-end which are unpaid but may still qualify for the settlement discount. In considering this issue, the thesis will explore whether what accrues is the full purchase price or the discounted price. The thesis will also offer an opinion on the appropriate interpretative principles to be applied in cases where the prompt settlement discount ‘accrues to’ the taxpayer at the end of the tax year. Also discussed is whether the principles applied to these cases promote fairness and certainty in an effective tax system.

## 1.3 RESEARCH OBJECTIVES

The research objectives are to:

- 1.3.1 Provide an analysis of South African case laws and the implication of the concept ‘amount accrued’ as interpreted by courts in order to:
  - a. Discuss the techniques applied by courts when construing tax legislations

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<sup>3</sup> Ibid.

<sup>4</sup> ITC 1816 (2006) 68 SATC 312.

<sup>5</sup> Ibid.

<sup>6</sup> [2007] ZAKZHC 40; [2008] 2 All SA 442 (N); (2007) 69 SATC 115 (NPD).

- b. Discuss the concept 'amount accrued' to the taxpayer in relation to a settlement discount
- c. Discuss the idea of a well organised tax system and the consistency in the interpretation of the tax laws by the courts.

**1.3.2** Analyse the concept of prompt settlement discount and the problems associated with it.

## **1.4 RESEARCH METHODOLOGY**

This research is mainly a desktop thesis which is library based and documented facts on this subject are being explored and various articles are also consulted for relevant information. A review of literature textbooks, journal articles, internet, thesis and case law will be undertaken to determine the income tax repercussions when the seller offers a prompt settlement discount to the purchaser.

## **1.5 LIMITATION OF SCOPE OF STUDY**

The purpose of this dissertation is limited to a consideration of the timing of an accrual in respect of early settlement discounts granted by the seller to a purchaser of goods or services and it will not discuss all tax issues relevant to settlement discounts.

Therefore, the question of other normal tax consequences and the VAT implications of a settlement discount do not fall within the scope of this dissertation.

The focus of this dissertation will be on the seller of goods or services where a provision for prompt settlement discount is included.

## **1.6 CHAPTER PLAN**

Chapter 1 of this dissertation introduces the problem associated with prompt settlement discount and the method to be used in resolving the conflicts.

Chapter 2 of this dissertation introduces the general principles that determine the meaning of 'amount accrued' to the taxpayer. This chapter will also discuss the timing of accrual with reference to decided cases.

Chapter 3 of this dissertation discusses the meaning of 'prompt settlement discount'.

Chapter 4 will consider the decision of the Tax Court which has now been overturned on appeal by the High Court and was later reported as *GUD Holdings (Pty) Ltd v CSARS*.<sup>7</sup> This chapter will also consider other relevant arguments or principles not discussed in *GUD Holdings* and *ITC 1816*.

In *GUD Holdings* the court had to consider whether the prompt settlement discount that formed part of the deal between the taxpayer and its clients ought to be included in the taxpayer's 'gross income' at the end of the tax year.

Arguments from the taxpayer (hereinafter referred to as the seller or appellant) will be discussed.

The relevant legislative provisions and other cases will be referred to and analysed only to the extent as required by the ambit of this study.

Chapter 5 will contain the concluding remarks of the study.

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<sup>7</sup> Ibid.

## CHAPTER 2: OVERVIEW OF THE BASIC ACCRUAL PRINCIPLES

### 2.1 INTRODUCTION

In order to address the objectives of this dissertation, this chapter will scrutinise the number of South African cases and pieces of legislation which interpret the implications of the concept 'accrued to' by the courts in order to get a clear understanding of this concept. Tax laws are complex and detailed and various concepts are not well-defined in the Income Tax Act. The courts have a duty to give meaning to those provisions, so that the law may be applied accordingly<sup>8</sup>. Understanding the interpretation of tax legislation is crucial to the research questions set out in chapter 1.

It is important to understand the timing of accrual for inclusion in the taxpayer's gross income, since values change over time. Due to the effect that the timing of accrual may have on the valuation of the amount it represents, various examples of case law which are related to the timing of accrual will be analysed in this chapter.

### 2.2 THE INTERPRETATION OF THE TERM 'ACCRUED TO' IN TERMS OF GROSS INCOME

For many years there was controversy around the meaning of the expression 'accrued to', as to whether it meant 'entitled to' an amount, or whether the amount should be 'due and payable'.<sup>9</sup>

The debate was finally resolved in *CIR v People's Stores (Walvis Bay) (Pty) Ltd*,<sup>10</sup> where the court decided that, 'an amount accrued to the taxpayer when he became unconditionally entitled to it, but that something must be deducted from the face value of an accrual that is receivable in a future year of assessment.'<sup>11</sup>

The issue of accrual was also considered in other cases. Some of these will now be considered.

In *ITC 521*,<sup>12</sup> the meaning of 'accrual' was also scrutinised. In this case, the taxpayer's trading stock was destroyed by a fire and a claim was made to their insurance company for compensation. The taxpayer was reimbursed for his losses and the income was incorporated into his gross income for taxation purposes. A few years later, it was discovered that the

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<sup>8</sup> Williams (1978)

<sup>9</sup> 1990 (2) SA 353 (A), 52 SATC 9 12.

<sup>10</sup> Ibid 12

<sup>11</sup> Ibid 12

<sup>12</sup> (1942) 12 SATC 408.

insurance company had also paid other amounts to the taxpayer, as per the insurance policy agreement, and that those additional amounts had also been taxed. The taxpayer appealed, based on the fact that the same amounts had already been incorporated into his gross income as accruals in the earlier tax years.

The appeal was dismissed, and the court decided that until the claim is approved by the insurer, the claim cannot accrue to the taxpayer. The court confirmed the assessment and the amount was then included as gross income for tax purposes in that year of assessment.<sup>13</sup>

This case brought to the fore the issue of timing when determining an 'accrual' and also discussed the term 'due and payable', as emphasised in *Lategan*,<sup>14</sup> with the purpose of exploring the meaning of the term. The amount in question was payable in terms of a policy agreement. However, the payment was not yet due: such payment had not yet been authorised because the taxpayer had to be notified before the authorisation took place. The taxpayer's position is clear in this situation, because the policy agreement stated that in the situation where a fire or certain natural disasters took place, the insurer should pay damages to the taxpayer and this payment would be accepted as an accrual to the tax payer.

Therefore, it can be accepted that if a fire or other natural disaster happens, as specified in the policy, and payment is made pursuant thereto, the accrual will take place when the event happens, even before notification or obtaining the insurer's approval.

In *Hersov's Estate v CIR*,<sup>15</sup> the court expounded on the meaning of the words 'accrued to'. Hersov was a director of a company, and a contract of agreement was concluded between him and the company. The contract stated that if it happens that Hersov dies, the business will pay 21.2% of its remaining possessions into Hersov's estate, as decided during the time of his death. Hersov passed away on 15 January 1949 and, as per the concluded contract, a large amount of money was paid into Hersov estate. In order to determine his income as from July 1948 up until the time of his death, the Commissioner had to incorporate this amount into the gross income for the tax year-end. Representatives of Hersov's estate appealed the decision and the Special court for hearing appeals decided that as per the contract between the parties, no amount should be paid until the time of Hersov's death, and the money paid could not be received or accrued for Hersov's final year of assessment. The court held further that the sum paid cannot be

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<sup>13</sup> Ibid.

<sup>14</sup> 1926 CPD 203, 2 SATC 16 20.

<sup>15</sup> 1957 (1) SA 471 (A).

incorporated into the taxpayer's gross income because accrual had taken place two months after Hersov's death, and the amount accrued was all for his estate.<sup>16</sup> It is evident from the court's judgment that "accrual" transpires when the amount comes to be 'due and payable'.

In *ITC 1488*,<sup>17</sup> the taxpayer resigned as an employee of a company and consequently also ceased to be an associated pension fund member. The issue the court had to deal with was the date of accrual for the taxpayer's resignation benefits, which were to be paid by the pension fund. As per agreement, the pension fund rewarded the taxpayer with the resignation benefit. It was stated in the contract of agreement that the pension fund had an optional rule to increase the benefits to be paid to its members. The taxpayer was then granted his resignation benefits as per agreement. However, he rejected this reward because he was not happy with it, and he requested an increase for his benefits. His request for more benefits was unsuccessful and he finally had to accept his original reward together with interest. The taxpayer was, however, successful in appealing the accrual date for his pension benefits, which was determined to be only when his submission as per the optional rule was decided, and not the date of original payment.<sup>18</sup>

The principle in this case shows that accrual take place only when the taxpayer become entitled to it and not when it is received. Therefore, the accrual rule is about entitlement, not amounts due and payable.

In *Lategan v CIR*,<sup>19</sup> Lategan was a wine farmer and he produced and sold wine in a certain tax year. In May 1920, he sold the bulk of the wine at a price of £5 924. Of that amount, £3 500 was paid to Lategan before the end of the tax year, which was 30 June 1920. The taxpayer was a member of the wine farmer's co-operative which controlled the selling of wine. The contract of the co-operative includes a phrase permitting a particular 'retention' and 'contribution' of moneys to be subtracted from the amount 'due and payable' to or 'received' by its members. The retained moneys were utilised for a co-operative's operating expenses, and the contribution moneys were utilised for its administrative costs and for making reserves which was eligible to be received by the taxpayer. The Commissioner incorporated the total sum of £5 924 into

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<sup>16</sup> *Ibid* page 9

<sup>17</sup> (1990) 53 SATC 56.

<sup>18</sup> *Ibid*.

<sup>19</sup> Note 11 17.

the taxpayer's gross income and rejected any deduction for 'retention' and 'contribution' moneys.<sup>20</sup>

The question before the court was: 'What amount had accrued to the taxpayer during the year of assessment in question, in addition to the amount received by the taxpayer?'

This case was brought before the CPD, where Watermeyer J said:<sup>21</sup>

In my opinion, the words in the Act 'has accrued to or in favour of any person' merely mean 'to which he has become entitled'. So far as a debt is concerned which is payable in the future and that in the year of assessment, it might be difficult to hold that the cash amount of the debt has accrued to the taxpayer in the year of assessment, but he has acquired a right to claim payment of debt in future. According to what has been stated above, the value of this right must in my opinion be included in the taxpayer's gross income for taxation purposes but something must be deducted from their face value to allow for the fact that they were not payable at the close of the year of the assessment.

This conclusion was supported by De Villiers, J.A. in *CIR v Delfos*<sup>22</sup> and also found full support *CIR v Hersov*.<sup>23</sup>

The Margo Commission report concluded that the test of entitlement is correct since it decides as to when the business acquire its assets. This commission was formed to investigate and to provide recommendations for the carrying out of a solid tax structure in the South African government. The commission stated that if the taxpayer became 'entitled to' an amount which is to be paid in the future tax year, due payment must be made when valuing the upcoming right after the end of tax year.<sup>24</sup>

The Margo Commission Report suggested that the court's decision in *Lategan* should be regarded as correctly reflecting the law.<sup>25</sup> The commission concluded that no further legislative resolution was necessary to analyse the meaning of the word 'accrued'.<sup>26</sup>

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<sup>20</sup> Note 11 16.

<sup>21</sup> Ibid 20.

<sup>22</sup> 1933 AD 242, 6 SATC 92.

<sup>23</sup> 1952 (1) SA 485 (A), 18 SATC 20.

<sup>24</sup> *Report of the Commission of Inquiry into the Tax Structure of the Republic of South Africa* (The Margo Commission Report) 1987 26

<sup>25</sup> Ibid.

<sup>26</sup> Ibid.

The court in *People's Stores*<sup>27</sup> upheld the accrual principle as discussed in *Lategan*.<sup>28</sup> The taxpayer in this case was a clothing company which sold its merchandise by cash and also on a 'six months to pay' basis. As per the credit scheme agreement, the purchaser would pay the seller in six equal payments. At the end of the tax year, the remaining instalments from the seller's books of account equalled to R341 281, which was due in the subsequent tax year. In the tax year-end, the Commissioner incorporated the amount for the remaining instalments into the taxpayer's gross income. The taxpayer objected this valuation based on the fact that the remaining payments were not yet due in the present tax year. Moreover, the taxpayer contended that if the Commissioner was going to include the remaining payments, only the current value of the amount had to be included, not the face value. The issue before the court was whether the remaining instalments in the tax year-end which were to be paid only in the following tax year ought to be incorporated in the taxpayer's gross income for the first-mentioned tax year, or whether the amount accrued only when the taxpayer become 'entitled to' it, or only when it became 'due and payable'.<sup>28</sup>

All five judges in the Appellate Division upheld the accrual principle as discussed in *Lategan* and unanimously ruled that 'the outstanding instalment accrued to the taxpayer in view of the fact that it was entitled thereto, although the amounts would only be due and payable in the following year of assessment'.<sup>29</sup>

Following this decision, the definition of gross income was amended in the Income Tax Act and the following *proviso* was added:<sup>30</sup>

Provided that where during any year of assessment the taxpayer has become entitled to any amount which is payable on a date or dates falling after the last day of such year, there shall be deemed to have accrued to him during such year:

- a) If the taxpayer has on or before 23 May 1990 submitted a return of income drawn on the basis that the present value of such amount has accrued to him during such year, the present value of such amount; or
- b) Any other case, such amount:

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<sup>27</sup> Note 8.

<sup>28</sup> Ibid 9–10.

<sup>29</sup> Note 8 20.

<sup>30</sup> Note 2.

Provided further that where the provisions of paragraph (a) of the first *proviso* are applicable, there shall be deemed to have accrued to the taxpayer during any subsequent year of assessment in which he receives such amount or portion thereof and the present value of such amount or portion thereof so deemed to have accrued to him during the first-mentioned year of assessment.

Paragraph (a) of the *proviso* was inserted to cater for those taxpayers who had submitted a tax return including the discounted value of a debt as gross income during the first tax year so that any further amount to be received from the taxpayer's debtor might be incorporated into the taxpayer's gross income in the subsequent tax year.

Paragraph (b) of the *proviso* requires the taxpayer to incorporate in gross income the face value of debt to be received for the sale of goods in the year during which goods are disposed of.

The notion of accrual brings with it additional complications when accrued income is considered. It is to address these complications that the *proviso* created an accrual rule which applies only at the tax year-end. Under the accrual rule, an amount which the taxpayer became 'entitled to' but which is to be paid in the subsequent tax year would be considered to have accrued during the current tax year when the taxpayer become 'entitled to' it. The *proviso* looks to the taxpayer's entitlement at the year-end to an amount payable after the year-end.<sup>31</sup>

Consequently, based on the facts of *People's Stores*, accrual, where a taxpayer is selling goods on credit with outstanding amounts from those credit sales which are due and payable in the following tax year, the full selling price should be incorporated into the taxpayer's gross income in the current tax year.

In *Ochberg v CIR*,<sup>32</sup> the court held that 'before an amount can accrue to a taxpayer, the taxpayer's right to claim payment must be unconditional'. Watermeyer J stated further:

If the right to claim future instalments is conditional or dependent upon the performance of certain obligations or the fulfilment of certain terms by the taxpayer, for example, the obligation to deliver property or render services, or the approval by a third party, there can be no accrual in terms of the Income Tax Act.<sup>33</sup>

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<sup>31</sup> *Silke on South African Income Tax* Volume 1 & 2 2016 para 2.9.

<sup>32</sup> 1933 CPD 256, 6 SATC 1.

<sup>33</sup> *Ibid.*

Therefore, if the right to claim payment is conditional, the accrual will happen after the duty has been completed or when the conditions are fulfilled. Until these conditions have been complied with, the taxpayer cannot be 'entitled to' claim such payments.

In *Mooi v Commissioner for Inland Revenue*,<sup>34</sup> the court extended the concept of 'accrued to' to mean unconditionally 'entitled to'. The court held that this was the correct interpretation.

The court stated that for an accrual to take place 'the amount should have a monetary value'. Williams elaborates on the concept 'accrued to' and says that 'where a taxpayer acquires a right which is conditional (depends on an uncertain future events), no valuable right accrues until the fulfilment of these conditions'.<sup>35</sup>

In this case, the court held that it was necessary to consider that upon the completion of the condition, the court allocates the value to the amount founded on the fair market value.<sup>36</sup> It was decided that this judgment actually safeguards the taxpayer from incorporating the amount into the gross income on basis of the accrual rule where the taxpayer could possibly not going to get the moneys if the conditions could not be fulfilled.<sup>37</sup>

*Silke*<sup>38</sup> provides examples illustrating the implication of 'accrued to' as mentioned in the *Lategan* case. The concept of 'entitled to' implies the taxpayer's right to income. In each example below, the last day of March 2016 would be the end of the tax year. These examples demonstrate the principle applied when establishing the date of accrual:<sup>39</sup>

- a) A business sells merchandise for R200 on 16 March 2016. As per agreement, the merchandise is to be distributed on 14 April 2016. The R200 will then accrue on 14 April 2016, only after the distribution has taken place, because pending the condition to be fulfilled, the taxpayer cannot be 'entitled to' the income. The taxpayer will be unconditionally 'entitled to' claim payment only when the delivery of the merchandise has taken place.
- b) A manufacturer of machines completed a machine on 1 March 2016. The price of the machine is R5 000. On 31 March 2016, the reasonable market value of the machine was

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<sup>34</sup> 1972 (1) SA 675 (A), 34 SATC 1 10.

<sup>35</sup> RC Williams *Income Tax in South Africa: Cases and Material* 2005 30.

<sup>36</sup> 1972 (1) SA 675 (A), 34 SATC 1 10

<sup>37</sup> Ibid 34.

<sup>38</sup> Note 27 para 2.8.

<sup>39</sup> Ibid.

R6 000. The machine was sold and delivered on 12 April 2016 for R6 100 and there were no accrual up until 12 April 2016, when the supplier becomes 'entitled to' the amount. On 31 March 2016, even though the machine was valued at R6 000, there was no accrual since the supplier was not 'entitled to' anything during the time of sale. There is an unrecognised increase in the value of the merchandise which cannot be taxed until the supplier acquires the right to claim payment of the income.

- c) A company announces a share dividend to its shareholders on 10 March 2016, to be paid on 15 May 2016. The time of accrual and the time of shareholders entitlement will be the date of announcement of the dividends which is on 10 March 2016.
- d) A business announces a share dividends on 12 March 2016 to be paid to shareholders on 1 April 2016 which is the date when the shareholders were registered on the share register. The dividends was in fact paid on 16 April. The time of accrual was, however, 1 April 2016 which was the date when a shareholder was obliged to be registered in order to take part on the dividends. It was only on 1 April 2016 that a shareholder was 'entitled to' the dividend. As the illustration demonstrates, the time of accrual was not the time of announcement or the time of payment of the dividend but a dividends "accrues to" the shareholders registered at the time of announcement.
- e) As per a building contract agreement, 20% of the agreed price would be reserved as 'retention monies' while waiting for a final certificate to be delivered by the engineer within six months after the building has been completed. The building was finished on 27 February 2016 and the engineer's finishing certificate was delivered and the constructor received the 'retention moneys' only on 29 September 2016. The time of accrual is therefore, the time of the engineer's finishing certificate, which is 29 September 2016, because before that date, the constructor was not 'entitled to' the 'retention monies'.
- f) If a wholesaler sells merchandise on credit for R200 on 1 March 2016 subject to a 'settlement discount' of R10 should the payment be made by 20 March 2016, the amount accrued at the end of March 2016 cannot be the full invoice price but is the discounted value of R190.

The examples illustrated above clearly define the absurd consequence which flow from different interpretations when the amount accrues to the taxpayer on the last day of the tax year but is payable in the following tax year or when the condition is fulfilled. These examples show

that until the taxpayer becomes 'entitled to' an amount or the unknown future event takes place, the amount cannot be incorporated into the gross income.

In *ITC 645*,<sup>40</sup> the taxpayer operated a rebate system whereby its customers had to pay their accounts in full within thirty days of the date of their statement to qualify for a rebate. The taxpayer would then send the customer a rebate cheque dated the fifteenth of the following month.

On 30 September, which was the taxpayer's financial year-end, the Commissioner included the full selling price as having 'accrued to' the taxpayer. The taxpayer maintained that the possible rebate amounts were conditional and had to be disqualified from the gross income calculation.

The court's view was that the taxpayer was 'entitled to' receive the invoice price under the particular rebate system as it was expressly agreed with customers that the customer would make payment in full and that they would not withhold the rebate.

The court found that 'all that was conditional was the customer's right to a rebate refund and that would depend on whether the customer [had] paid before the end of October'.<sup>41</sup>

The taxpayer was therefore still entitled to be paid the full sales prices. The court accordingly included the full amount of the invoices in the gross income of the taxpayer.

In *GUD Holdings*, the taxpayer contractually agreed with its purchasers that they would be entitled to a prompt settlement discount on the purchase price if payment was received not later than the 25th of the month ensuing the month in which the invoice was issued. At the end of the year of assessment, certain debts were outstanding in respect of which the discount could still be applicable.

The issue before the court was 'what had accrued to the taxpayer as at midnight on 30 June 2003'. SARS alleged that what had accrued to the taxpayer on 30 June 2003 was the face value for the merchandise sold to the purchaser for *GUD Holdings*. The taxpayer claimed that the amount accrued was the one to which the taxpayer was 'entitled to' should the amount owing be paid within the prescribed period.

In this case, it was therefore uncertain whether the liability of the customers was the full invoiced amount or whether it was the discounted value. The court decided that the taxpayer

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<sup>40</sup> 61 SATC 31 35.

<sup>41</sup> ITC 645 (61) SATC 31 35.

was unconditionally entitled to the discounted purchase price only on conclusion of the agreement and therefore held that only that part of the outstanding debts should form part of the taxpayer's gross income in that year of assessment.<sup>42</sup> Therefore, a discount period should first expire before the taxpayer would become entitled to the balance of the purchase price.<sup>43</sup>

Because this case is the most relevant to this dissertation, the specific facts of the case will be discussed in full in chapter 4.

Based on the abovementioned principles, it is clear that the meaning of 'accrual' implies that the taxpayer should be entitled to an amount in question. This means that if the goods are sold on credit at the end of the tax year but are 'due and payable' only in the following year, the seller has a vested right to claim future payment in the following year, and such payment will be included in a taxpayer's gross income in the current tax year. The important qualification in this matter is that the taxpayer's entitlement to the amount must be unconditional. In the situation where the right to future payment is 'conditional', there is no accrual and the taxpayer is not entitled to the amount until the condition is fulfilled.

### **2.3 TIMING OF ACCRUAL AND ITS VALUATION**

In the past, the courts have debated on matters of timing with regard to 'when an amount should be incorporated into the gross income for tax purposes'. The court decisions relating to timing issues will be briefly discussed in order to ensure that valuation of the amount 'accrued to' the taxpayer takes place appropriately and precisely. These discussions will give a clear indication as to when the amounts accrued to the taxpayer and consequently be incorporated into the taxpayer's gross income in the tax year-end.

*Silke*<sup>44</sup> recommends that the appropriate time of accrual for a non-cash item, such as payment in kind, assets, foreign exchange and barter trade system will be the actual time of accrual, and the decision of the courts in *Mooi* supported this proposal.<sup>45</sup>

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<sup>42</sup> Note 6 page 445

<sup>43</sup> Note 6.

<sup>44</sup> Note 27 para 2.7.

<sup>45</sup> Note 30.

*Meyerowitz*<sup>46</sup> supplies a list of examples analysing the timing of accrual:<sup>47</sup>

- a) Cash sales: If the contract of sales call for cash on delivery, the principle used suggest that the accrual takes place at the conclusion of such contract.
- b) Credit sales: Accrual takes place when the supplier has become entitled to payment and the payment is made.
- c) Hire purchase: If a hire purchase contract of agreement has been concluded, the principle suggest that the accrual takes place at the time when the contract is concluded.
- d) Rental: If the lease contract is permanent and the rent payment cannot be determined before the period is finished, the complete term of rental accrues to the lessor after the lease contract has been concluded, because the lessor has played his part by providing the lessee with the leased property and the lessor is therefore unconditionally entitled to the rental payment.
- e) Dividends: Dividends accrue on the date of declaration and will be paid to shareholders registered on that specific date.
- f) Partnerships and joint ventures: Accruals of partnerships and joint ventures accrue to each partner simultaneously as they accrue to the partnership.
- g) Commission: If commission is going to be paid on the assumption of the contract, the time of assumption will be the time of accrual. However, if the commission is going to be paid when the merchandise has been delivered, or when payment is made by the borrower, the accrual time will take place upon delivery or payment.
- h) Option contract: Throughout the duration of the option contract, the payments accruing are believed to have accrued day by day.
- i) Unpaid accruals: If an accrual is due to the taxpayer, the fact that the buyer cannot pay his dues will not change the taxpayer's position as per gross income. There is an option for bad debts which permits a deduction if the debt is afterwards proved to be bad.
- j) Sale of business with retrospective effect: This means that if the contract of sale is concluded on 31 October, the customer should acquire profit or accept the loss as from

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<sup>46</sup> D Meyerowitz *Meyerowitz on Income Tax* 2008.

<sup>47</sup> Ibid paras 6.19–6.37.

1 August. While the contract between the parties is still valid, it must be given effect. The total amounts accrued up to the time of concluding the contract accrue to the taxpayer and he is also 'entitled to' claim the allowable deductions.

- k) Sale of business subject to a suspensive sale condition: This takes place when the business is sold on condition that the sale will take place only when the transfer licence has been handed over. In this case, the taxing of the profit or loss in the provisional term rests on the execution of the terms of the agreement. If the buyer is heading for a business purchase on his own account, while waiting for the condition to be fulfilled, the accruals go to the seller despite the fact that, as per contract, the buyer is 'entitled to' the profit as provided in the agreement.
- l) Sale of business subject to a resolution condition: This means that the deal will be terminated if the amount due is not paid on time. Here, the sale takes place from the time when the contract came into operation. The time of cancellation, should the deal be cancelled, will be at the instigation of the buyer and not the seller, and the buyer should explain for everything received or accrued to the seller. This situation arises where the buyer cannot be considered as a trustee for the 'receipts' or 'accruals'. Therefore, the receipts and accrual are the buyer's assets. The fact that a buyer will be required to be responsible for all receipts or accruals to the seller when the resolution condition is fulfilled does not assign a trust to the buyer.
- m) Contract for the benefit of a third party: Here, the contract is for disposing of an asset by the two parties in order to benefit a third party (*stipulatio alteri*). In this case, the tax matters will be administered by the contract. For example, A agrees with B, and as per agreement, B sells his assets to C based on the condition that the sale will be effective only when C receives the benefit of the contract. Until C receives the benefit, accrual goes to B. In contrast, if the sale is effective instantly, A himself being responsible should C fail to accept the benefit, then the accruals are in the meanwhile deemed to be income for the trust.

Since the definition of 'gross income' provides that only the amounts received or accrued to the taxpayer during a particular year of assessment are subject to tax in that specific year, so in support of the above mentioned list, it is important that all amounts received or accrued is taxed in the correct year of assessment. If the amounts accrued and received in the same year of

assessment, does not cause any conflicts but the problem begins when the amount accrued is not received before the end of the tax year.

The timing of accrual was also dealt with in the following cases:

In *South African Marine Corporation Ltd v CIR*,<sup>48</sup> the court submitted that ‘when an amount accrues to a taxpayer on the last day of the year of assessment, such amounts should be valued on the accrual date’.

The details in this case were that the taxpayer was running a cargo shipping business in South Africa and America. An amount of £662 300 was kept by the American business for the taxpayer’s benefit. The taxpayer recorded all items in his accounting books and when the payment was made, he received an amount of £60 920 extra compared to the recorded amount in the accounting books. That amount was considered to be an exchange profit, and the Commissioner incorporated the same amount of money into the taxpayer’s gross income for tax purposes.<sup>49</sup>

The critical question turned on: ‘at what point should the accrual be valued during the year of assessment?’<sup>50</sup> The court decided that the amount of accrual should be valued on the accrual date. In this case, the date when the transaction took place was the date of accrual. To arrive at this conclusion, Ogilvie Thompson J decided as follows:

It follows that appellant’s trading operations as conducted by States Marine on its behalf – which operation it is convenient to call appellant’s American trading operations – attract Union tax: that is beyond dispute and is not questioned in this appeal. As, however, those operations are reflected in American dollars, and because, for purposes of Union taxation, appellant’s account must be expressed in Union currency, it is necessary for appellant in its books to reflect its American trading operations in terms of Union points. In my opinion, such conversion of dollars into South African pounds should be made at the rate of exchange prevailing on the date where under the items concerned – where credit or debit – appear in the general account kept by States Marine; for it is at such dates that (assuming States Marine’s accounts to have been correctly kept) the accrual or receipt of income occurs.<sup>51</sup>

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<sup>48</sup> 1955 (1) SA 654 (C), 20 SATC 15.

<sup>49</sup> Ibid.

<sup>50</sup> Ibid 16.

<sup>51</sup> Ibid 20.

In *Lategan's* case, the court adopted a different view when it proposed that an amount accrued to the taxpayer on the last day of tax year must be established.

Watermeyer J held:

Assuming that the right to receive the instalments was not converted into money by sale or otherwise during the year of assessment, the value to be fixed (apart from any question whether the debt was good or bad) would be the present value worth of the instalments at the end of the year.<sup>52</sup>

Therefore, when it comes to debts which the taxpayer has not yet discharged, the amount spent in that tax year should be included at the end of the tax year unless such items were disposed of before that year-end.

In *Matla Coal*, the taxpayer received payment of R9 365 000 from Eskom and such amount was described as an amount of capital nature which cannot be incorporated into his gross income. The commissioner incorporated the said amount into the taxpayer's gross income and the taxpayer made an objection to this assessment because the amount was of capital nature which could not be incorporated into the gross income for tax purposes.<sup>53</sup> *Matla Coal* decided that there are two opposing views when it comes to the time of valuation. The first maintains that the accrual date must be used and the second uses the last day of the tax year. These two conflicting views had been revisited by the Appellate Division, and the Court found it unnecessary to choose any viewpoints since the position obtained during payment did not change until the year-end.<sup>54</sup>

In *Mooi v SIR*,<sup>55</sup> the court decided that '[w]hen the taxpayer obtains a conditional right, the date of accrual will only be the date when the condition is completed'.<sup>56</sup> The court also decided that for the amount to accrue to the taxpayer, such amount should have a monetary value. In *Mooi*, the taxpayer was working for the copper mining business called Palabora Mining Co Ltd. The taxpayer was given an opportunity by the mining business on 25 July 1963 to subscribe for 500 shares valued at R1, 25 per share. This opportunity provided various options,

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<sup>52</sup> Note 11 17.

<sup>53</sup> 1987 (1) SA 108 (A), 48 SATC 223.

<sup>54</sup> *Ibid* para 32.

<sup>55</sup> Note 30.

<sup>56</sup> *Ibid* 11.

including an option which could not be exercised until six months after the newly built mine, situated in Palabora, was completed, and only employees were entitled to exercise this option. The company granted this option to the taxpayer for his services and to motivate him to remain an employee of the business.

In October 1966, the taxpayer chose to apply the said opportunity. The market share value by this year was R6, 40, which was R5.15 more than the option price of R1.25 for each share. The Commissioner included these additional amounts as 'gross income'. The taxpayer opposed the inclusion based on the fact that what had accrued to him was the right to exercise an option which he had acquired on 27 July 1963. The court stated that all that had accrued to the taxpayer was the right to obtain shares valued at R1, 25.<sup>57</sup>

The accrual occurred when the option was exercisable on 1 September 1966, while the taxpayer was still employed by the mining company and there was a fundamental link amongst the benefit achieved and his service rendered.<sup>58</sup>

Ogilvie Thompson CJ concluded his judgment by stating the following:

In order to determine the 'amount' comprehended by this definition it is necessary, in this case of right, to establish the value of that right. In my opinion the right acquired by the appellant (the taxpayer) on 27 July 1963 lacked any inherent attribute of income and, but for the provision of paragraph (c) of the definition of gross income, would appropriately be regarded as a right of a capital nature. The object of paragraph (c) of the definition is of course to bring into the category of gross income all amounts whether of a capital nature or not accrued in respect of services' [emphasis added].<sup>59</sup>

The court also decided that when a taxpayer become 'entitled to' a right which will be incorporated into the gross income, a monetary value must be allocated to that right. The contingent right which the taxpayer had acquired on 27 July 1963 borrowed an expression used by Sellers LJ in Abbot's case whereby it was decided that the amount accrued to the taxpayer when the option was due to be exercised on 1 September 1966. The benefit which was given to the taxpayer was the right to apply for the shares at R1.25 per share, and that right took place when the latter became exercisable. The court stated that, 'this case dealt with accrual valuation

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<sup>57</sup> Ibid 1–2.

<sup>58</sup> Ibid 6.

<sup>59</sup> Ibid 7.

and also illustrated the principles of timing of accrual and the causal link between the accrual and services rendered or to be rendered.’<sup>60</sup>

Therefore, it is of importance to take note of the fact that issues of ‘accrual’ and the ‘timing of accrual’ are still controversial since the courts have provided different views and the Income Tax Act does not provide clarity as to how to deal with these issues, especially where the accrual valuation is conditional.

## 2.4 CONCLUSION

Considering the number of South African cases discussing the meaning of the expression ‘accrued to’ for the purpose of inclusion in the gross income has shown that the courts have finalised many cases which are associated with the meaning of the term ‘accrual’. In *Lategan*, the court held that the meaning of the term ‘accrual’ means ‘to which he has become entitled’.<sup>61</sup>

In *People’s Stores*, the then Appellate Division upheld the accrual principles as laid down in *Lategan* and also confirmed that the term accrual means entitlement to an outstanding debt. The present value for an amount accrued was also confirmed. However, after the introduction the *proviso* into the definition of ‘gross income’, the taxpayer would be ‘entitled to’ an amount accrued to him on the last day of the tax year even though such amount is payable in the following tax year.

In order to determine what amount accrues to a seller at the year-end, in respect of those amounts which are unpaid but may still qualify for the settlement discount, it is necessary to apply the accrual principles as decided in *Lategan* and *People’s Stores*. Since the expression ‘accrued to’ was extended to mean unconditionally ‘entitled to’ in *Mooi*,<sup>62</sup> the court submitted that ‘if the right to claim future payment is conditional, until the condition is fulfilled, there can be no accrual to the taxpayer’.<sup>63</sup>

Chapter 3 will discuss interpretation of the concept settlement discount for incorporation into the taxpayer’s gross income at the end of tax year. First, the concept will be discussed and analysed in general and will also use applicable case law to clarify the principles. The meaning

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<sup>60</sup> Ibid

<sup>61</sup> Note 11 20.

<sup>62</sup> Note 30 10.

<sup>63</sup> Ibid.

of the terms 'contingent right' and 'vested right' will also be discussed in order to address the meaning of the term 'accrued to' as illustrated by the principles in *Mooi v SIR*,<sup>64</sup> where the meaning of the word 'unconditionally' has been ascribed to the word 'entitled to'.

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<sup>64</sup> Ibid.

## **CHAPTER 3: INTERPRETATION OF SETTLEMENT DISCOUNT PROVISIONS**

### **3.1 INTRODUCTION**

In order to address the second goal of this thesis, this chapter will analyse the concept of early settlement discount and the problems associated with determining accrual to the taxpayer in the subsequent tax year. This chapter will also evaluate the applicable case law and explain the tax implications of applying the provisions of a settlement discount.

It will be shown that determining whether the settlement discount accrues to the taxpayer will depend upon whether the taxpayer's entitlement to the amount on the last day of the tax year is conditional or not. If the taxpayer's entitlement is conditional (dependent on uncertain future events), there can be no accrual on the part of the taxpayer until the condition is fulfilled on the expiry of the early settlement period. If the taxpayer's entitlement is unconditional, as provided for in the *proviso*, the taxpayer will be entitled to the full invoice price (that is, the undiscounted price).

### **3.2 SETTLEMENT DISCOUNT PROVISIONS**

A settlement discount allows the purchaser to pay less than the invoiced price of goods or services if he makes payment within a stated period. In most instances the purchaser obtains the discount by reducing the selling price by the value of the settlement discount available.<sup>65</sup>

Smith stated that if there is a settlement discount provision in the sale agreement, the purchaser may obtain a settlement discount of the selling price if he makes payment within the defined settlement period. Up until the expiration of that settlement period, the purchaser is merely entitled to the reduced amount, which is the selling price minus the settlement discount. After the prompt settlement period has run its course, the supplier is entitled to the full selling price. In the tax year-end, the supplier is 'entitled to' the selling price minus any offered settlement discount which the purchaser has the choice of exercising.<sup>66</sup>

In support of the argument stating that the seller has become entitled to only the lesser amount, the concept of 'conditional entitlement' is relevant. In a situation where conditional entitlement is an issue, (for example, where the entitlement is conditional and depends on the fulfilment of

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<sup>65</sup> B Keirby-Smith 'Deductibility of provisions Part 2' 2012.

<sup>66</sup> Ibid.

certain requirements or the happening of an uncertain future event), there will be no accrual until the condition is satisfied. This view was supported by Ogilvie Thompson CJ in *Mooi v SIR*<sup>67</sup> where he said:

[a]ccordingly, I am of the opinion that no accrual within the meaning of the definition of 'gross income' occurred in July 1963, but that the relevant accrual occurred when the option became exercisable on 1 September 1966. The real benefit conferred upon appellant, which was at all material times in the contemplation of all concerned, was the right to apply for the shares at R1.25 per share, and that right arose when, upon fulfilment of the conditions of the option, the latter became exercisable.

Therefore, where a sales agreement has been concluded on the tax year-end, and the performance has been effected as per agreement, there is an accrual of the full selling price to the seller during such tax year.

In *People's Stores*,<sup>68</sup> Hefer JA confirmed the principles as applied in *Lategan v CIR*,<sup>69</sup> holding that such principles reflected the law correctly:

In my opinion, the words in the Act, 'has accrued to or in favour of any person' merely mean 'to which he has become entitled'.<sup>70</sup>

In this situation, the seller has become entitled to an amount in terms of the sale agreement. However, what must be established is the amount to which the seller has become entitled.

Therefore, where the purchaser took advantage of the settlement discount option and paid earlier in time to qualify for a settlement discount, the seller is entitled to the invoice amount reduced by any available settlement discount which the purchaser has successfully exercised an option for.

In applying the court's reasoning, in a sale concluded on the tax year-end and to be paid in the subsequent tax year, the seller has only a conditional entitlement to the invoiced price, which may be claimed by the purchaser as a settlement discount. Since the entitlement to the discountable portion remains conditional, there can be no accrual on the part of the seller until the condition is fulfilled on the expiry of an early settlement period.

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<sup>67</sup> Note 30.

<sup>68</sup> Note 8.

<sup>69</sup> Note 11 16.

<sup>70</sup> *Ibid* para 20.

However, the *proviso* which was introduced in response to the decision reached in *People's Stores*<sup>71</sup> case arrived at a different conclusion. The *proviso* reads as follows:

Provided that where during any year of assessment the taxpayer has become entitled to any amount, which is payable on a date or dates falling after the last day of such year, there shall be deemed to have accrued to him during such year such amount.<sup>72</sup>

It is submitted that the abovementioned *proviso* was intended to prevent the discounting of an amount payable at a future date purely on the basis of the time delay. In simple terms, this *proviso* stops the taxpayer who is taking an amount which accrues in the current tax year, but which is receivable in the following tax year, by discounting the face value of that accrual simply because there is a time delay between the accrual and the receipt.

Therefore, it is submitted that the basis on which gross income has been reduced by the amount of settlement discount cannot be compared to the situation covered in the *proviso* for the definition of gross income.

Furthermore, the court in *People's Stores* held that 'in order to determine the issue of whether the settlement discount formed part of the taxpayer's gross income during the financial year in question depends on the facts of each case'.<sup>73</sup> When dealing with the settlement discount provision, the key issue is whether the taxpayer's entitlement to the amount is conditional or unconditional.

Jiyane submitted that if the legislature had applied the same approach which has been applied by the accounting profession when defining the word 'accrued to', the situation could be less complicated. She submitted that as per accounting expressions, AC111 is an income statement which deals with the accounting treatment of income. In taxation, income can be associated to gross income even though the latter is not well-defined in the Income Tax Act. As per AC111, the income will only be earned after it is *probable* that the financial advantage related to the deal will run to the business. The word 'probable' may possibly be somewhere between 50% and 100%. These percentages serve as a guiding principle as to when income is received in the taxpayer's gross income for taxation. Probability is about certainty of receiving income.<sup>74</sup>

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<sup>71</sup> Note 8.

<sup>72</sup> Note 2.

<sup>73</sup> Note 8.

<sup>74</sup> GN Jiyane 'Received by' and 'accrued to' (Unpublished LLM thesis – University of Kwa-Zulu Natal) 2008 18–19.

### 3.3 DISTINCTION BETWEEN CONTINGENT RIGHTS AND VESTED RIGHTS

The concepts of contingent rights and vested or delayed rights address the meaning of the term 'accrued to' as illustrated by the principles in *Mooi v SIR*.<sup>75</sup> Since the Income Tax Act does not provide any clarity regarding accrual income, and the *proviso* does not constitute the full range of possible tax outcomes, these concepts will serve as a recommendation for incorporating the earned income in the taxpayer's gross income.

Jiyane also referred to the Generally Accepted Accounting Principles (GAAP) when describing these concepts and said that a contingent right is a right which depends on the happening of certain future events. This clearly means that this right may never be vested in the taxpayer until the certain condition is fulfilled. This contingent right is also called a conditional right because it cannot be enforced until the unknown forthcoming occasion occurs. It is also called accidental or prospect right.<sup>76</sup>

On the other hand, a vested right can be defined as a right of ownership combined with the enjoyment of that right even though it may be postponed.

The GAAP statement provides specific guidelines which are similar to the court decisions when dealing with contingent right. These guidelines provide that a contingent asset or rights normally comes about when an unknown or uncertain future event which has the possibility of bringing a flow of economic benefit or income to the individual for tax purposes occurs. Trading services can be regarded as a salary or selling goods for income. A good example of trading services is when an entity pursues claims by means of legal process and the result of such process is unknown.<sup>77</sup> An entity means anyone who is trading and may be taxed in terms of the legislation.

Contingent rights are therefore not acknowledged in accounting books because this may cause acknowledgement of revenue that will probably not be achieved. However, if economic flow is possible, these rights can be disclosed. However, if the achievement of income is possible, then the right is not a contingent right and its acknowledgement is correct.<sup>78</sup>

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<sup>75</sup> Note 30 10.

<sup>76</sup> Note 69 19.

<sup>77</sup> Ibid.

<sup>78</sup> Ibid.

When one compares accounting principles and legal decisions, a contingent right can never be regarded as a vested right. This principle has been properly demonstrated by the court in *Mooi v SIR*.<sup>79</sup>

This judgment confirms that the contingent right can never be a vested right even though the contingent right can have money value during acquisition of such right.

However, the difference between contingent and vested rights is significant because a right which does not depend on the occurrence of unknown future events cannot be regarded as a contingent right but can be described as a vested right. For example, if the employer decides to pay a 13th cheque to an employee on 23 December 2016, as a gesture of goodwill and without any conditions attached, such right is not conditional but a vested right, the enjoyment of which is delayed until a future date which is definite to come.

In *Mooi v SIR*,<sup>80</sup> the court indicated that if a right or expectation which may never be realised accrues to the taxpayer, such expectation should be allocated a value in order to verify whether such amount may be incorporated into the taxpayer's gross income. Alternatively, if the taxpayer's right cannot be valued, there will be no amount available for incorporation into the taxpayer's gross income.

In summary, the court in *Mooi* recognised that a contingent right cannot be a vested right, and such rights should not be viewed as a sum 'accrued to' the taxpayer for incorporation into the gross income, despite the fact a contingent right has cash significance during the period of achievement of such right. On the other hand, a postponed right cannot be a contingent right but is a vested right in the legal sense.

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<sup>79</sup> Note 30 10.

<sup>80</sup> Ibid.

### 3.4 CONCLUSION

After taking into account the concept of conditional entitlement, which is always attached to the settlement discount provision, it is certain that the total amount accrued to the taxpayer at the end of the tax year, in respect of those amounts which are unpaid but may still qualify for the settlement discount, cannot be a selling price but must be the lesser value (the discounted price). Therefore, the *proviso* in the definition of gross income does not apply to this method of valuation.

In concluding first, that in the settlement discount provision, the amount 'accrued to' the taxpayer at the year-end is the lesser amount; and, second, that the *proviso* to the definition of gross income does not apply to this valuation, it is therefore submitted that a settlement discount provision should be considered when valuing a debtor's balance at the tax year-end.

The practical application of these arguments would require the seller to deduct all outstanding settlement discounts from the purchaser's account which are still within the defined settlement period. The settlement discount provision could then be calculated by applying the settlement discount percentage to the amount extracted. A more complicated situation may arise only where the settlement discount percentage varies between customers.

Chapter 4 will consider the decision of the Tax Court which has now been overturned on appeal and reported as *GUD Holdings*. This chapter will also consider other relevant arguments or principles not discussed in the *GUD Holdings* and *ITC 1816* cases. The court had to consider whether the prompt settlement discount could be incorporated into the taxpayer's gross income at the tax year-end. The arguments from the taxpayer (hereinafter referred to as seller or appellant) will be discussed and the relevant legislative provisions and other cases will be referred to and analysed only to the extent required by the ambit of this study.

## CHAPTER 4: ANALYSIS OF *GUD HOLDINGS*

### 4.1 INTRODUCTION

The current chapter will scrutinise the judgment of *GUD Holdings* in detail. This will further explore the first objective of this research by analysing case law concerning the courts' analysis of the meaning of the word 'accrued to' as it applies to early settlement discounts for incorporation into the gross income. The details of this case together with the arguments given by the taxpayer will then be presented in more detail. After considering the thorough interpretation method used by the court in valuing the right to the amount 'accrued to' the taxpayer in the form of settlement discount, the shortcomings regarding the decisions taken by the courts will be addressed. The precedent set by *GUD Holdings* and the statement that 'a settlement discount is not actually a discount as stated in the contractual agreement but is a penalty which will be imposed for late payment'<sup>81</sup> will be strongly criticised. The chapter will then conclude by discussing the procedure that should be followed by courts when valuing the amount accrued to the taxpayer in the form of settlement discounts by referring to the precedent set by *Mooi*. This case will be analysed in order to conclude that what precisely had accrued to the taxpayer as at the end of the relevant tax year is the discounted price as oppose to the full invoice price.

### 4.2 ANALYSIS OF THE DECISION IN THE *GUD HOLDINGS* CASE

The facts in *GUD Holdings (Pty) Ltd v CSARS* (herein after referred to as *GUD Holdings*) were that *GUD Holdings* was a maker and supplier of automotive parts which rendered a discount scheme for the buyers of its goods as a motivation for early payment. Contracts were concluded between the buyer and the company and the important provision of the contracts was that:

[s]hould payment be made by the purchaser to the seller not later than the 25th day (or earlier full business day) of the month following the month during which delivery takes place, the purchaser shall be entitled to deduct a settlement discount from his payment, in accordance with the seller's discount scheme which may be revised by the seller from time to time.<sup>82</sup>

Therefore, the accepted statement of facts which was prepared as per section 107A of the Rules of the Tax Court described the meaning of the 'discount scheme' and said a taxpayer operated a discount scheme for its purchasers. The parties agreed that the purchaser was entitled to a

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<sup>81</sup> Note 6.

<sup>82</sup> Ibid 443–444.

settlement discount if the purchaser paid on or before the 25th day of the month follows after the invoice was delivered. A purchaser will pay the invoice price minus the settlement discount. A duplicate for an invoice will be provided by the taxpayer to the purchaser. The scope of the settlement discount contract is arranged beforehand with each purchaser on a percentage basis. The potential settlement discount is described as provisions on the sales agreement.

In the taxpayer's accounting records, the provisions against each purchaser's settlement discount were raised. The provision shows that only the selling price after subtracting the settlement discount was incorporated into the taxpayer's gross income. This provision would be reversed if a purchaser failed to pay by the 25th day of the month after which the invoice was made out. The taxpayer noted its income in the books of account as an amount outstanding after subtracting the provision.<sup>83</sup>

In calculating the taxpayer's gross income in the tax year-end, the taxpayer recorded the gross selling price excluding VAT in respect of monies not yet received and withheld the potential settlement discount, describing the former amounts as provisions.

In effect, in order to calculate the taxpayer's gross income for the final tax year-end, the taxpayer considered the remaining amounts after subtracting the settlement discount as its gross income for the year. The total amount of the so-called provisions that the appellant had excluded from its gross income had been calculated with the hope that 'the debtor would pay its account within the stipulated period and therefore be entitled to the settlement discount'.<sup>84</sup>

The taxpayer was subjected to an audit by SARS and as a result was given an added taxation for the 2003 tax year, and the gross income escalated by R4 371 015. This amount included the early settlement discount provided for on 30 June 2003.<sup>85</sup>

The Commissioner argued that in respect of those amounts which were unpaid but still qualified for the discount, the full purchase price had accrued to the taxpayer, whereas the taxpayer argued that only the discounted price had accrued to it and not the full purchase price.

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<sup>83</sup> Ibid 443.

<sup>84</sup> Note 4.

<sup>85</sup> Note 6.

*GUD Holdings* was decided on appeal from *ITC 1816*,<sup>86</sup> where the judgment of the Tax Court held that 'the sole issue to be determined was whether the prompt settlement discounts formed part of the taxpayer's gross income during the financial year in question'.<sup>87</sup>

The taxpayer contended that whether there had been an accrual depended on the correct interpretation of the taxpayer's standard contract terms and argued that, 'the right to the discounted amount accrues, but there is no entitlement on the part of the appellant to recover the amount of the discount. That entitlement arises only if the relevant date has passed and the customer is therefore not entitled to the discount.'<sup>88</sup>

The Tax Court responded as follows:

On closer analysis, counsel contends for two-fold accrual. The first is the amount of the purchase price less the discount that accrues immediately and is rightfully part of the gross income in that financial year.

The second element of the purchase price which is the amount of the discount can only accrue when the purchaser does not take advantage of the offer of a discount. Whether the purchaser pays on due date or not is an uncertain future event and entitlement to the additional element of the purchase price which is discount only arises then.

We consider that, while the counsel's argument is very attractive, it cannot be accepted. Clause 1.1 of the taxpayer's standard conditions of sale speaks of payment.

Payment in our view means payment of the amount invoiced. The agreement provides that if payment is made by a certain date, the customer is entitled to deduct the discount. The invoice annexed is interesting. The customer is given a volume discount of 8%. After deduction of that discount, the purchase price of R242, 79 is reflected (excluding VAT).

The purchaser is informed that if that price is paid by 25 July 2003, it will be entitled to a settlement discount.

In our view 'settlement' means settlement of the price indicated on the invoice. The statement of account as at 25th of June 2003 annexed reflects the said invoice for R276, 76 (including VAT). This statement shows in our opinion that the taxpayer debited the full purchase price. Upon timeous payment, the customer is only then given a credit.<sup>89</sup>

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<sup>86</sup> Note 4.

<sup>87</sup> Ibid.

<sup>88</sup> Ibid.

<sup>89</sup> Note 4.

The Tax Court<sup>90</sup> further held that:

This is a clear pointer against Mr Shaw's submission because it indicates an intention on the part of the taxpayer to receive, as at date of invoice and statement, the amount of the invoiced purchase price. The manner in which the debtor's amount is reflected as at 30th of June 2003, that is to say, the amount less the discount because of the so called 'provisions', is in our view wholly inconsistent with the taxpayer's existing accounting procedures. Dealing with its debtors as at 30th of June 2003 in this way cannot, as counsel for the Commissioner submits, alter the situation nor indeed can entries in books of accounts ever transform an artificial state of affairs into reality. We hold therefore that the accrual occurred as at the statement date in respect of the full invoiced amount. The Commissioner's contentions are therefore correct, the assessment is confirmed, and the appeal falls to be dismissed.

In summary, the Tax Court said that the customer became entitled to a discount only on timeous payment and unless and until this occurred, the seller had a right to the full undiscounted price. Levinsohn DJP dismissed the taxpayer's appeal and upheld the assessment. The taxpayer was not satisfied and appealed.

#### **4.3 THE HIGH COURT JUDGMENT IN THE *GUD HOLDINGS* DECISION**

On appeal, the issue before the court was 'what had accrued to the taxpayer as at midnight on 30 June 2003'.<sup>91</sup> SARS alleged that what had accrued to the taxpayer on 30 June 2003 was the face value for the merchandise sold to the purchaser for *GUD Holdings*. The taxpayer claimed that the amount accrued was the one to which the taxpayer was 'entitled to' should the amount owing be paid within the prescribed period.

The Natal Provincial Division cited the principle laid down in *Lategan v CIR*<sup>92</sup> and confirmed by the court in *People's Stores*,<sup>93</sup> that any form of property, including a right, 'accrues' to the taxpayer immediately upon right vesting in him and that the value of the right or the amount so accrued is the amount of money which the taxpayer could get if he chose to sell the right.

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<sup>90</sup> Ibid.

<sup>91</sup> Note 6 445.

<sup>92</sup> Note 11.

<sup>93</sup> Note 8.

Based on the principles as discussed in *Lategan* and *People's Stores* cases, the question is simple:<sup>94</sup> 'What was the value of the taxpayer's right at midnight on 30 June 2003?'

In *Lategan*, Watermeyer J stated:<sup>95</sup>

If at the close of the tax year, the taxpayer had wanted to turn its right to unpaid debts into money, what amount would it recover for them. I do not think that there can be any debate but that a factor would only be prepared to pay the taxpayer the selling price less the discount provided for because this would be all the debtor was obliged and was likely to pay. Based on this approach, it is, in my view erroneous to suggest that the full invoice price had accrued to the taxpayer as part of its gross income at the close of the tax year.

Hurt J, for the court of appeal, pointed out that the argument was connected to precisely 'what had accrued to the taxpayer as at midnight on 30 June 2003'.<sup>96</sup> SARS alleged that what had accrued to the taxpayer on 30 June 2003 was the face value for the merchandise sold to the purchaser for *GUD Holdings*. The taxpayer claimed that the amount accrued was the one to which the taxpayer was 'entitled to' should the amount owing be paid within the prescribed period.<sup>97</sup>

Hurt J referred to *People's Stores*,<sup>98</sup> *Cactus Investments*<sup>99</sup> and *ITC 645* in his dictum.<sup>100</sup>

*GUD Holdings* responded on the question of what had accrued to the taxpayer on the last day of the year of assessment in respect of those amounts which are unpaid but may still qualify for the settlement discount.<sup>101</sup> The final decision reached by the court in this case shows that a pattern has now been set for future settlement discount cases where the taxpayer's right to payment is conditional and the 'discounted price' should accrue to the taxpayer on the last day of the tax year.

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<sup>94</sup> Note 6 445.

<sup>95</sup> Note 11 209–210.

<sup>96</sup> Note 6 445.

<sup>97</sup> *Ibid.*

<sup>98</sup> Note 8.

<sup>99</sup> 1999 (1) SA 315 (SCA).

<sup>100</sup> Notes 35 & 36.

<sup>101</sup> Note 6 445.

#### 4.4 CRITICISM OF THE HIGH COURT DECISION IN *GUD HOLDINGS*

Subject to the particular situations of the case, a taxpayer may be justified in seeking to exclude from gross income the amount of settlement discounts to be paid after the tax year-end but only when goods are sold before the end of such tax year.

Jiyane suggested that there are gaps on the accrual principles which have been emphasised in many court judgments and also in a *proviso* for the definition of gross income.<sup>102</sup> The *proviso* focuses on the taxpayer's entitlement to an amount at the end of the tax year which is to be paid on the following tax year. It applies the *Lategan* principles and explains that to be 'entitled to' an amount means 'to be entitled to claim payment' of the same amount. The amount will comprise both cash and a cash value, but the *proviso* does not make any mention of the amount articulated in cash.<sup>103</sup>

*Silke* suggested that the *proviso* is referring to the two different amounts: there is one which is in specific terms and the other one is by implications. The first amount is the one to which the taxpayer is 'entitled' on the last day of the tax year. Such amount could not be valued or else the *proviso* would appear to be contrary to the *Lategan* principles. Since the *proviso* recommends the *Lategan* principles, it shows that total remaining amounts to be paid after the tax year-end are to be valued on the last day of the tax year. This discussion shows that a settlement discount ought to be considered and the total amounts to be paid in the future should be reduced to their current values. The second amount is the one to be paid at an unknown future date. If the said amount is articulated in cash and should be valued on the time of payment, the face value should be incorporated into the gross income. This understanding will accomplish the objectives for the *proviso* in an ordinary income tax system.<sup>104</sup>

*Silke* also suggested that there was an error of reasoning finished in the *proviso* which assumed that there is an alternative outcome obtainable in paragraphs (a) and (b) of the *proviso*, which constitutes a collection of possible decisions. It is also submitted that the lawful meaning of an expression 'amount' has been ignored and that this is a mistake of law.<sup>105</sup>

Jiyane also suggested that the *proviso* seems to recognise the remaining settlement discounts when valuing the remaining accruals in the tax year-end. Even if the contrary were correct, it

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<sup>102</sup> Note 69 42

<sup>103</sup> Note 69 42.

<sup>104</sup> *Silke* on South African Tax Vol 1 2007 para 2.6.

<sup>105</sup> *Ibid* para 2.7.

may possibly be contended that 'entitlement' means 'to which one may sue'. If the seller offers a settlement discount to a purchaser at the end of tax year, he cannot bring a claim for a full payment of the invoice price. The contract amongst the purchaser and the seller is that the seller may possibly claim payment on the same day, which would be decreased by the settlement discount.<sup>106</sup>

What is immediately striking about the High Court judgment is that, having correctly identified the decisive principles, as laid down in *Lategan's* case, which state that an amount accrues to a taxpayer upon the vesting of the right, the court then failed to analyse the effect thereof on the settlement discount operated by *GUD Holdings* in terms of those fundamental concepts.

It is unfortunate that the High Court failed to apply the principles as decided in *Mooi v SIR*,<sup>107</sup> where the concept of 'conditional entitlement' was an issue. The court held that where entitlement is conditional on the fulfilment of a certain requirement or occurrence of an event, there can be no accrual until the condition is met. This view was supported by Ogilvie Thompson CJ in *Mooi v SIR* in his judgment, where he said:

There is no accrual within the meaning of the definition of gross income occurred in July 1963, but that the relevant accrual occurred when the option became exercisable on 1 September 1966. The real benefit conferred upon the appellant at all material times was the right to apply for the shares at R1.25 per share and that right arose upon fulfilment of the conditions of the option, [when] the latter became exercisable.<sup>108</sup>

In applying this reasoning to the sale concluded in the tax year-end, the seller had only a 'conditional entitlement' to that portion of the invoice price that might be claimed by the buyer as a settlement discount. Until the condition was fulfilled, by the expiry of the early settlement period, no accrual existed as the entitlement to the discountable portion remained conditional.

It is also unfortunate that the court failed to put under a spotlight the precise language of the seller's contractual terms and ask whether a right vested immediately to the seller on conclusion of the contract and if so, whether it was a right to the full purchase price.

Instead of framing the question in terms of tax law principles as laid down in the *Lategan* and *People's Stores* cases by asking what right vested in the taxpayer immediately the contract was

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<sup>106</sup> Note 69 43.

<sup>107</sup> Note 30.

<sup>108</sup> Ibid 12.

concluded, the court instead asked what economic result was 'aimed at' by the parties when entering into an agreement or transaction. Therefore, this decision is an egregious misdirection because the issue of whether income has accrued to the taxpayer depends on whether the legal right has vested, not on whether a particular economic objective was sought.

It was also not helpful for the court to use the purported analogy of sale on terms whereby interest accrues if payment is not done after a certain date. Analogies are seldom exact, and the court would have done well to heed the sage warning of Innes CJ in *CIR v George Forest Timber Co Ltd*,<sup>109</sup> which provides as follows:

It is dangerous in income tax cases to depart from the actual facts; the true cause is to take the facts as they stand and apply the provisions of the Statute.

In order to determine whether a right has 'vested in' and has therefore 'accrued to' the taxpayer at a given point in time as required by the *Lategan* principle, it is submitted that tax law takes into account only unconditional rights, and not those rights which are still inchoate because they may never ripen into unconditional entitlement.

It is also submitted that *GUD Holdings* turned on the way in which the contract in question was worded. It is considered that the agreed statement of facts correctly summarised its legal effect where it said '[i]n terms of this scheme, the wholesaler is entitled to a settlement discount if the wholesaler makes payment by the stipulated date'.<sup>110</sup>

Therefore, the right to a discount arose only if the uncertain future event came to pass, namely if the purchaser made timely payment of the price. Unless and until that contingency became reality, the taxpayer was entitled to the full purchase price.

The tax consequences turn on the way in which a contract is expressed, because it is the contract which determines whether and when a 'right' has 'vested' in the taxpayer and exactly what that right is.

In *GUD Holdings*, the High Court held that 'the settlement discount is not so much a discount as it is a penalty which will be added for late payment'.<sup>111</sup> This statement flies in the face of

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<sup>109</sup> 1924 AD 516.

<sup>110</sup> Note 6 445.

<sup>111</sup> *Ibid* 444.

what the contractual terms actually said, namely, that if payment was made timeously, the purchaser would have a right to subtract the settlement discount from the amount paid.

#### 4.5 CONCLUSION

The current chapter has discussed the High Court judgment of *GUD Holdings* in more detail. In this case, the court judgment finally proved that a pattern has now been set for future settlement discount cases. The discounted price must accrue to the taxpayer in the tax year-end in respect of those amounts which are unpaid but may still qualify for the settlement discount.

The *GUD Holdings* decision has been strongly criticised by PwC<sup>112</sup> in that there were many important matters which the court failed to address. Even though the taxation of accrual in the form of settlement discount was raised, the court failed to make a clear decision as to whether accrual in the form of settlement discount should be incorporated into the taxpayer's gross income or not. Based on the *Mooi* and *GUD Holdings* cases, the possibility that accrual income in the form of a settlement discount could be taxed in future does not exist.

The *GUD Holdings* decision has been discussed and the criticism concerning the judgment has also been presented in detail. The counsel for *GUD Holdings* addressed the court decisions in the *Lategan* and *People's Stores* cases and held as follows:

As soon as the amount becomes unconditionally and un-contingently due to a taxpayer, it must be recognised as income that accrues to the taxpayer in the year of assessment in which he acquires the right to claim payment in the future, not in the year of assessment in which he eventually is entitled to claim payment.<sup>113</sup>

However, in *GUD Holdings*, the court failed to address the method for valuing an amount accrued to the taxpayer where the entitlement to the amount is conditional on the fulfilment of certain requirements or the happening of a particular event, as discussed in *Mooi*.<sup>114</sup> Another criticism referred to the fact that the court did not analyse the precise language of the seller's contractual terms.

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<sup>112</sup> PricewaterhouseCoopers, Synopsis Tax today, 2007 6

<sup>113</sup> Note 6 444.

<sup>114</sup> Note 30.

## CHAPTER 5: CONCLUSION

### 5.1 INTRODUCTION

This research has concentrated on the difficulties encountered in assessing the value of an amount which accrues to the taxpayer's gross income in the form of an early settlement discount.

The courts' interpretation of what amounts to gross income has revealed inconsistencies. The courts have been forced to interpret the term gross income because the Income Tax Act does not give the full meaning of the word.

As a result of inconsistency in the courts' decisions, ambiguity remains when interpreting fiscal law, particularly when valuing the amount accrued to the taxpayer in the form of settlement discounts.

This research has concentrated on the court's analysis of the expression 'accrued to', the amounts which accrued to the taxpayer in the tax year-end, and how such amounts should be incorporated into the gross income by virtue of the decisions in *Lategan* and *People's Stores*.

In *GUD Holdings*, the court was called upon to decide on the situation where the seller sells goods on credit and offers a settlement discount to purchasers who pay timeously. The court had to determine what amount (the full purchase price or the discounted price) accrued to the seller at the end of the year in respect of those amounts which were unpaid but might still qualify for the settlement discount: was it the full purchase price or the discounted price? The High Court concluded that 'it would be erroneous to suggest that the full purchase price had accrued to the taxpayer as part of its gross income at the close of the tax year'.<sup>115</sup> This means that the discounted price ought to be incorporated into the taxpayer's gross income.

This research also provided some criticism of the *GUD Holdings* judgment and demonstrated the difficulties arising from the fact that having correctly identified the decisive principles (an amount accrues to a taxpayer upon the vesting of the right) as laid down in *Lategan's* case, the court failed to analyse the effect on the settlement discount operated by *GUD Holdings* based on those fundamental concepts. The court also failed to apply the principles as decided in the case of *Mooi*, where the concept of 'conditional entitlement' was an issue. In the *Mooi* case,

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<sup>115</sup> Note 6 445.

the court held that where entitlement is conditional or depend on the fulfilment of certain requirements or the happening of an event, as is the case in *GUD Holdings*, there can be no accrual until the condition is met.

## 5.2 FINDINGS OF THE RESEARCH

Chapter 2 of this research dealt with interpreting fiscal law. Case law, concerning the expansion of the term 'accrued to', and the valuation of such amounts were analysed in order to arrive at a clear understanding of the concept 'accrued to' for incorporation into the taxpayer's gross income.

Through many years of debate in South African law, there has been a controversy in relation to the exact meaning of the expression 'accrued to' whether it intended 'entitled to' or 'due and payable'.

However, in *People's Stores*, the court decided that it meant '[a]n amount accrued to the taxpayer when he becomes unconditionally entitled to it', but that 'the present value of the right to future payment can be obtained by deducting an amount from the face value of an accrual that is receivable in a future year of assessment'.<sup>116</sup>

There were more problems encountered by the courts when determining the timing for the amount accrued to the taxpayer for inclusion in the gross income. These problems arose because of contradictions relating to the interpretation of the concept 'accrued to'.

The court decided that for an amount to be incorporated into the gross income, the taxpayer needed to be 'unconditionally entitled' to such amount. It is held that this judgment actually protects the taxpayer from incorporating an amount into the gross income by only relying on the accrual principle, which may possible not be received if the condition fail to be accomplish.<sup>117</sup>

Chapter 3 of this research addressed the second goal by analysing the concept of 'early settlement discount' and the problem associated with it in general in order to conclude which amount accrues to the taxpayer where the amount is to be paid on the subsequent tax year. It

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<sup>116</sup> Note 8 20.

<sup>117</sup> Ibid.

went further to analyse the applicable case law, and illustrated the consequences of applying the provisions of settlement discounts.

This chapter also stipulated that whether the settlement discount accrues to the taxpayer at the tax year-end depends on whether the taxpayer's entitlement to the amount is conditional or unconditional. If the taxpayer's entitlement is conditional (dependent on uncertain future events), there can be no accrual on the part of the taxpayer until the condition is fulfilled on the expiry of the early settlement period. If the taxpayer's entitlement is unconditional, as provided for by the *proviso* in the definition of gross income, the taxpayer will be entitled to the full invoice price (the undiscounted price).

When applying the court reasoning for the decision in the *Mooi* case, the amount which accrues to the taxpayer in the tax year-end in respect of those amounts which are unpaid but may still qualify for the settlement discount is the lesser value (the discounted price) because of the settlement period available to the purchaser that has not expired at the year-end. The '*proviso*' is not applicable in this method of valuation.

Chapter 4 of this research set forth the facts of *GUD Holdings* and referred to the arguments advanced by the Commissioner and the taxpayer company. The Commissioner for SARS argued that in respect of those amounts which are unpaid but still qualify for the discount, the full purchase price has accrued to the taxpayer, whereas, on the other hand, the taxpayer's counsel argued that only the discounted price accrues to the taxpayer, and not the full purchase price.

*GUD Holdings* was the appeal from *ITC 1816*,<sup>118</sup> where the judgment of the tax court held that 'the sole issue to be determined was whether the prompt settlement discounts formed part of the taxpayer's gross income during the financial year in question'.

*GUD Holdings* decided on the question of what had 'accrued' to the taxpayer in the tax year-end in relation to those amounts which are unpaid but which may still qualify for the settlement discount. The court held that the taxpayer would be entitled to a selling price minus the 'settlement discount' as provided in clause 1.3. The decision reached by the court in this case means that a pattern has finally been set for future settlement discount cases where the taxpayer's right to payment is 'conditional' and the 'discounted price' should accrue to the

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<sup>118</sup> Note 4.

taxpayer at the year-end with regard to those amounts which are unpaid but may still qualify for the settlement discount.

Chapter 4 also criticised the decision in *GUD Holdings* case in that there were many issues which the court failed to address. An example of one of these issues was that even though the taxation of the accrual in the form of the settlement discount was raised, the court failed to make a clear decision as to whether this kind of accrual ought to be incorporated in the taxpayer's 'gross income' or not. Based on the court judgment in *Mooi* and *GUD Holdings*, the likelihood that accrued income in the form of a settlement discount could be taxed in future does not exist.

The counsel for *GUD Holdings* addressed the court decisions in *Lategan* and *People's Stores* and held that:

[a]s soon as the amount becomes unconditionally and un-contingently due to a taxpayer, it must be recognised as income that accrues to the taxpayer in the year of assessment in which he acquires the right to claim payment in the future not in the year of assessment in which he is eventually entitled to claim payment.<sup>119</sup>

However, the said counsel failed to address the method for valuing an amount accrued to the taxpayer whereby the entitlement to the amount is conditional, which depends on the fulfilment of certain requirements or happening of a particular event as discussed in *Mooi*. The court was also criticised for not analysing the precise language of the seller's contractual terms.

Chapter 4 drew the conclusion that when the sale is concluded at the tax year-end, the seller has a 'conditional entitlement' to that portion of the invoice price that may be claimed by the buyer as a settlement discount. Until the condition is fulfilled, by the expiry of the early settlement period, no accrual exists as the entitlement to the discountable portion remains conditional.

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<sup>119</sup> Note 6 444.

### 5.3 CONCLUDING REMARKS

In applying the court's reasoning in *GUD Holdings*, where the sale was concluded in the tax year-end, the seller had a 'conditional entitlement' to the invoice price which might be claimed by the purchaser as a settlement discount. Since the entitlement to the discountable portion remained conditional, there could be no accrual on the part of the seller until the condition was fulfilled on the expiry of the early settlement period.

Based on the court's reasoning, where the purchaser took advantage of the settlement discount option and paid earlier, the seller is 'entitled to' the invoice amount reduced by any available settlement discount where the purchaser has exercised the option of a settlement discount. However, the present research found that the *proviso* does not apply since the taxpayer is not entitled to the portion of the price that represents the settlement discount.

It was also found that the abovementioned *proviso* was intended to prevent the discounting of an amount payable at a future date purely on the basis of the time delay. In simple terms, this *proviso* stops the taxpayer who is taking an amount which accrues during a current tax year, but which is receivable in the following tax year, by discounting the face value of that accrual simple because there is a time delay between the accrual and the receipt.

*GUD Holdings* case has been widely criticised by PwC<sup>120</sup> because the court failed to put the precise language of the seller's contractual terms under the spotlight and ask whether a right vested immediately to the seller on conclusion of the contract; and if so, whether or not it was a right to the full purchase price. Instead of framing the question in terms of tax law principles as laid down in *Lategan* and *People's Stores* by asking what right vested in the taxpayer immediately the contract was concluded, the court instead asked what economic result was 'aimed at' by the parties when entering into an agreement or transaction.

The present research has concluded that in applying the reasoning of the court in the *Mooi* case to the sale concluded in the tax year end, as is the situation in the *GUD Holdings* case, the taxpayer has only a 'conditional entitlement' to that portion of the invoice price that may be claimed by the purchaser as a settlement discount. Until the condition is fulfilled by the expiry of the early settlement period, no accrual exists as the entitlement to the discountable portion

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<sup>120</sup> Note 105.

remains conditional. This means that the market value or discounted value of the amount ought to be incorporated into the taxpayer's gross income at the end of the tax year.

This decision will present fairness and consistency in the interpretation of tax laws by the courts especially when settlement discount is part of the deal. This decision will actually protect the taxpayer from being taxed on an amount, by relying on accrual rule, which may possibly not be received if the condition fails to be accomplished.

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