COMMISSIONER, SOUTH AFRICAN REVENUE SERVICE V BRUMMERIA RENAISSANCE (PTY) LTD AND OTHERS: DOES THE JUDGEMENT BENEFIT AN UNDERSTANDING OF THE CONCEPT "AMOUNT"?

[Discussion of the judgement of Cloete JA in *Commissioner, South African Revenue Service v Brummeria Renaissance (Pty) Ltd and Others* 2007 6 SA 601 (SCA)]

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1 Introduction

It has been said that the decision by the Supreme Court of Appeal (SCA) in *Commissioner, South African Revenue Service v Brummeria Renaissance (Pty) Ltd*[1] is the most important tax case decided in the past 30 years.[2] The case has far-reaching consequences for the many retirement village developers who financed the construction of units in retirement villages by obtaining interest-free loans from retirees in return for granting occupation rights in respect of these units. Questions have also been raised regarding the possible application of the decision to other interest-free loans and even other areas of taxation law.

The case deals with the question whether a borrower of money under an interest-free loan can be taxed on the "benefit" of not having to pay interest. This paper argues that this question should be answered in the negative, since the borrower does not *acquire property* and no *amount* accordingly *accrues to* or *is received by* her, as required by the definition of "gross income".

At the outset, a short summary of the facts in *Brummeria* will be provided, followed by the definition of "gross income". The meaning of a number of concepts that are central to this definition, namely "received by", "accrued to" and "amount" will then be considered. It will be argued that the concept "accrued to" requires an *acquisition* of a right by the taxpayer. It will also be argued that the concept of "amount" requires the existence of *property.* Thereafter, regard will be had to the concept of "property", and specifically

[1] Also cited as [2007] SCA 99 (RSA); 69 SATC 205; [2007] 4 All SA 1338 (SCA) The judgement was delivered by Cloete JA Scott and Van Heerden JJA and Kgomo and Mhlantla AJJA concurred

[2] For example Visser "Duister Heers oor Belasbaarheid van Rentevrye Lenings" *Sake24* (25/09/2007) available at www news24 com/Sake/Rubrieke/0,,6-103_2189846,00 html (accessed 26 November 2007) and Visser "Staat Moet Ingryp Teen dié Leningstaks" *Sake24* (17/09/2007) available at www news24 com/Sake/Algemene_nuus/0,,6-1607_2185023,00 html (accessed 26 November 2007)

those property rights that usually flow from a monetary loan. Finally, an answer to the question whether the "right to retain and use loan capital interest-free" is *property* that *accrues* to or is *received by* the borrower will be sought.

2 Facts in *Brummeria*

The taxpayers were three companies, each conducting the business of developing retirement villages. This entailed that the taxpayer companies entered into written contracts with potential occupants of units to be constructed in the retirement villages. In terms of these contracts, a potential occupant would make a monetary loan to a particular taxpayer company in order to finance the construction of a unit in a retirement village by that taxpayer company. The relevant taxpayer company then issued a debenture to the lender/retiree in acknowledgement of the loan, endorsed the title deeds of the relevant unit and registered a covering bond as further security in favour of the lender/retiree.

The loan did not bear interest.[3] As counter-performance for the granting of the loan, the taxpayer companies granted the right of lifelong occupation of the relevant unit to the lender/retiree, but ownership remained with the relevant taxpayer company. The taxpayer company was obliged to repay the loan to the lender/retiree upon cancellation of the contract, or upon the lender/retiree's death.[4]

The Commissioner included amounts representing the "benefit of the rights to interest-free loans" in the gross income of the taxpayer companies for a number of years of assessment. These amounts were determined by applying the weighted prime overdraft rate for banks to the average amount of the particular interest-free loan in the relevant year of assessment.[5]

The taxpayer companies raised two grounds in their statement of grounds of appeal. The only one relevant to this discussion[6] is the argument that the inter-

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[3] It is questionable whether the loans were, indeed, "interest-free", although this was not raised by the taxpayers as a ground of appeal and was thus not addressed by the Tax Court or SCA in their respective judgements On the one hand the standard loan contract referred to the loan as "rentevry", but on the other hand it specifically indicated that the loan was made as a counter-performance for the granting of the life-long right to occupy the unit See para 3 of *ITC 1791* 67 SATC 230 ("the Tax Court judgement") for abstracts of the terms of the standard loan contract A possibility discussed by Prof Van Wyk during a SAFA seminar held at Century City on 20 November 2007 is that the contract between the taxpayer companies and the retirees was a *pactum antichreseos* Such a *pactum* gives a mortgagee (in this case the retiree) the right to use the mortgaged property in lieu of interest on the loan capital See "Mortgage and Pledge" *LAWSA XVII* para 477

[4] There is some uncertainty as to whether the obligation to repay the loan was unconditional The standard contract concluded between the respective taxpayer companies and the lenders/retirees is not reproduced in its entirety in either the Tax Court or SCA judgement According to clause 8 4 of the contract (cited at para 3 of the Tax Court judgement) repayment of the loan was subject to "voorwaardes" contained in another clause, the latter clause not being reproduced in the judgement With no further information, it must be assumed (as it apparently was by the Tax Court and the SCA) that the obligation to repay was unconditional

[5] Paras 12 and 14 of the Commissioner's statement of the grounds of assessment, quoted at para 5 of the SCA judgement The valuation method was never challenged by the taxpayer companies and was accepted by the SCA without consideration Since the Tax Court found in favour of the taxpayers on the ground that no amount was received by or accrued to the taxpayer companies, the valuation method was never considered by the Tax Court either For criticism on the valuation method used by the Commissioner, see Cilliers "*Brummeria Renaissance:* The Interest Free Cat among the Borrower Pigeons" 2007 *The Taxpayer* 184 186 – 187

[6] The other ground dealt with an administrative issue

est-free loans did not result in any *amounts* having *accrued to* or *being received by* the taxpayers as contemplated in the definition of "gross income".[7]

The case was initially heard by Goldblatt J at the Johannesburg Tax Court,[8] who found in favour of the taxpayer companies on this ground. Goldblatt J subsequently granted the Commissioner leave to appeal to the SCA in terms of section 36A(5) of the Income Tax Act[9]. Goldblatt J's decision was subsequently overturned in favour of the Commissioner.[10]

3 Definition of "gross income"

In light of the Commissioner's argument that the "benefit of the rights to interest-free loans" formed part of the "gross income" of the taxpayer companies, this definition requires consideration. At the time the definition of "gross income" read as follows:[11]

> "… the total *amount*, in cash or otherwise, *received by* or *accrued to* ... [the taxpayer] during such year or period of assessment … excluding receipts or accruals of a capital nature..."[12]

The concepts "received by", "accrued to", and "amount" are considered in more detail below.

4 Meaning of "received by" and "accrued to"

4 1 The realisation principle

It is a well established principle of our income tax law that, in order to constitute "gross income", some or other form of realisation must first take place. This requirement is explained by Professor Ross Parsons, a well-known Australian authority on tax, in the following manner:[13]

> "There must be a gain which *has a source in an obligation undertaken by another, or in a payment of money or transfer of property by another*."[14]

This requirement was recognised by our courts as early as in *ITC 110*[15]. In that case a speculative builder completed a house for sale in one year of assessment and sold it in the next. The taxpayer's contention that it ought to

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7 An argument that the "amounts" were of a capital nature and thus not "gross income" was not properly raised as a ground of appeal and thus not considered by the SCA Refer to para 10 of the SCA judgement It is assumed throughout this paper that the benefit in question was of a non-capital nature

8 *ITC 1791* 67 SATC 230

9 Act 58 of 1962

10 Although the SCA found in favour of one of the taxpayers in respect of the administrative ground of appeal

11 S 1 of the Income Tax Act 58 of 1962 Although the definition has since been amended, the amendments are not relevant to this discussion

12 Emphasis added

13 Parsons *Income Taxation in Australia: Principles of Income, Deductibility and Tax Accounting* (1985) para 2 28 available at http://purl library usyd edu au/setis/id/p00086 (accessed 26 November 2007) Refer also to the classic definition of income in *Commissioner v Glenshaw Glass Co* (1955) 348 US 426 as "instances of undeniable accessions to wealth, *clearly realised*, and over which the taxpayers have complete dominion" Emphasis added

14 Emphasis added

15 4 SATC 59

be taxed on some of the profits in the first year was rejected by the court on the ground that the taxpayer had not realised any of the profits in that first year.[16]

The realisation requirement is expressed by the words "received by or accrued to" in the definition of "gross income".

4 2 Meaning of "received by"

A taxpayer "receives" income if she obtains physical control[17] over money or money's worth.[18] Clearly, however, not every such instance will be regarded as a receipt for purposes of the definition of "gross income".[19] Rather, this will only be the case if the taxpayer receives the money or money's worth on her own behalf for her own benefit.[20]

4 3 Meaning of "accrued to"

The meaning of the concept "accrued to" was settled in *Commissioner for Inland Revenue v People's Stores (Walvis Bay) (Pty) Ltd.*[21] On the facts, the taxpayer had an unconditional right to receive payment in future. The Court held that "accrued to" means *to become entitled to* an amount (here the right to payment); in other words, *to acquire* an (unconditional) *right*. In defining "accrued to" in this manner, our courts have created a link between the concepts of "accrued to" and "amount", as explained in more detail below.[22]

5 Meaning of "amount"

When ascribing meaning to the word "amount" in the context of "gross income" two questions arise. The first question deals with whether an "amount" refers only to receipts that can be turned into money *by the taxpayer*, or to all receipts that have an *objective monetary value*. This question was the main issue considered by the SCA in *Brummeria,* where the latter meaning was ultimately favoured. The second question is which kinds of accruals or receipts constitute "amounts". This entails an inquiry into whether an "amount" includes only receipts or accruals that are *property*, or rather all *benefits* (irrespective of whether or not they are property). This paper does not deal with the first question in any detail. Instead, it focuses on the second

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16 See also *Land Dealing Co v CoT* 1959 3 SA 485 (SR) 496 where Beadle J held, with reference to s 8 of the Rhodesian Income Tax Act 16 of 1954 (which has a similar definition of "gross income) that "gross income" did not include a so-called "notional receipt" or "notional accrual"

17 Physical control is arguably not always required If, for example, payment is made by way of electronic transfer, the payee will, for purposes of the definition of "gross income" "receive" the amount transferred, even though she did not get "physical control" over a thing

18 *Commissioner for Inland Revenue v Genn & Co (Pty) Ltd* 1955 3 SA 293 (A) 301 In *ITC 1789* 67 SATC 205 208 Levinsohn J defined "receive" as "the physical act of taking possession of the amounts paid" In *Commissioner of Taxes v G* 43 SATC 159 the word "received" in the definition of "gross income" in s 8(1) of the Rhodesian Income Tax Act was defined, with reference to the Short Oxfort Dictionary, as "[t]o take into one's hands, or into one's possession (something held out or offered by another); to take delivery of (a thing) from another … for oneself…"

19 *Commissioner for Inland Revenue v Genn & Co (Pty) Ltd* 1955 3 SA 293 (A) 301

20 *Geldenhuys v Commissioner for Inland Revenue* 1947 3 SA 256 (C) 266

21 1990 2 SA 353 (A) 363I-364C

22 See 5 2 below

question. However, these two questions are not unrelated and brief reference will thus also be made the first question.[23]

5 1 Only receipts and accruals of property are "amounts"

In *WH Lategan v Commissioner for Inland Revenue*,[24] the taxpayer sold wine in one year of assessment, but payment was only due in the following year of assessment. The Court held that the right to receive payment was property to which the taxpayer became entitled in the first year of assessment and that this was an amount that had accrued to the taxpayer. In reaching his decision, Watermeyer J held as follows:[25]

> "In his Lordship's opinion the word 'amount' had to be given a wider meaning and must include not only money *but the value of every form of property earned by the taxpayer whether corporeal or incorporeal which has a money value*."[26]

Lategan's definition of an "amount" as "any form of property" was accepted in *Commissioner for Inland Revenue v People's Stores (Walvis Bay) (Pty) Ltd*.[27] In the latter case, an "amount" was also defined as any "rights" with monetary value of a non-capital nature.[28] The definition in *People's Stores* was in turn accepted in *Cactus Investments (Pty) Ltd v Commissioner for Inland Revenue*.[29] The definitions in *Lategan* and *People's Store* were also both quoted with approval by the SCA in *Brummeria*.[30]

Despite the general acceptance of *Lategan*'s definition of an "amount" as "any form of property", the question as to whether a receipt or accrual constitutes property (and thus "gross income") has seldom been directly considered by our courts.

An exception is the judgement in *Stander v Commissioner for Inland Revenue*.[31] In that case the taxpayer received an overseas trip as a prize and the Commissioner sought to include the value of the prize in his taxable income. The prize was awarded by Delta Motor Corporation (Pty) Ltd, which was not Stander's employer. Friedman JP found that no property accrued to the taxpayer before he went on the overseas trip by virtue of provisions of the General Law Amendment Act.[32] The gift could thus, before he had gone on the trip, not have been an amount.[33]

Unfortunately, our courts have not always exercised due care in their use of the relevant terminology. For example, in *Commissioner for Inland Revenue v Butcher Bros (Pty) Ltd*[34] Feetham JA held that all the lessor's "benefits" with

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23 See 5 3 below
24 1926 CPD 203
25 207
26 Emphasis added
27 1990 2 SA 353 (A) 363I-364C
28 365A
29 1999 1 SA 315 (SCA) 319G-H
30 Paras 11 and 16 of the SCA judgement
31 1997 3 SA 617 (C) Friedman JP also held that no property accrued to the taxpayer at a later stage for the reasons given in 5 3 below
32 S 5 of Act 50 of 1956
33 *Stander v Commissioner for Inland Revenue* 1997 3 SA 617 (C) 622D-H
34 1945 AD 301 The issue in the case was whether an "amount" was received by or accrued to the taxpayer as a premium or like consideration in respect of the grant of a right for the use or occupation of premises under s 7(1)(d) of Act 40 of 1925

an ascertainable money value would constitute an amount.[35] However, on the facts, the lessor's "benefits" were contractual rights that arose in terms of a lease contract and were thus in any event property in the form of personal rights. Furthermore, in light of the acceptance by Feetham JA of the principle in *Lategan's* case that only receipts and accruals with ascertainable monetary value could institute "gross income", it seems unlikely that, had he contemplated a wider meaning of the word "amount" (which would also include benefits other than property), he would not have expressly stated so.

The concepts of "amount" and "accrued to" are linked in that both require the existence of a subjective right as represented by the concept of *property*. As explained above,[36] it has been held that an accrual can only take place if a taxpayer acquires a *right*: if the taxpayer acquires, for example, a mere *spes*, there is neither an accrual nor an amount, for the reasons set out above.

This link is illustrated by the decision of Jansen J in *ITC 1810*.[37] In that case, the taxpayer invested money at interest with a certain A under a pyramid scheme. Soon afterwards, A became insolvent without ever having paid any interest to the taxpayer. Jansen J had to decide whether any interest that could constitute gross income in the hands of the taxpayer had accrued to him. He referred to *Fourie NO and Others v Edeling NO and Others,*[38] where it was decided that a "promise" to pay returns under a pyramid scheme was a nullity.[39] He thus held that, since the taxpayer never had an (unconditional)[40] right to claim interest from A, the interest did not *accrue to* the taxpayer.[41] Similarly, it can be said that the taxpayer did not acquire an *amount*.

Based on the repeated acceptance by the SCA of *Lategan*'s definition of "amount" as "any form of property," it can be concluded that only accruals and receipts in the form of *property* will constitute an amount for purposes of "gross income".

5 2 Meaning of "property"

"Property" is not easily defined under modern South African law. The meaning of the word differs considerably depending on the context in which it is used.[42] In South African law, a person's "property" is traditionally defined with reference to the subjective rights which that person holds.[43] A subjective right is a claim that a person (a legal subject) has to a legal object as against other persons.[44] Four, or possibly five, subjective rights are recognised: real

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35 321

36 See 4 2 above

37 68 SATC 189

38 [2005] 4 All SA 393 (SCA) para 19

39 Presumably this means that no obligations arise under such "promise"

40 Although Jansen J held that the taxpayer never had an "unconditional right" to payment of the interest, it is arguable that he never had any contractual right, unconditional or otherwise, in light of n 39 above The possibility of a claim based on unjustified enrichment is not considered

41 192 See n 39 above

42 See Badenhorst, Pienaar & Mostert *Silberberg and Schoeman's The Law of Property* 5 ed (2006) Ch 1 for the different contexts in which the word is often used

43 "Things" *LAWSA XXVII* para 195

44 Badenhorst et al *Property* 9; Van der Vyver "The Doctrine of Private-Law Rights" in Strauss (ed) *Huldigingsbundel vir WA Joubert* (1988) 201 214; Du Plessis *An Introduction to Law* 3 ed (1999) 145

rights, personal rights, immaterial property rights, personality rights and, possibly, personal immaterial property rights. The first two are particularly important to this paper and are discussed in more detail below.

The respective legal objects to which these subjective rights relate are:[45] things (the legal object of real rights), performances[46] (the legal object of personal rights), aspects of a natural person's personality (the legal object of personality rights), immaterial property (the object of immaterial property rights) and personal immaterial property (the object of personal immaterial property rights).

It is usually accepted that an object must have value in order to qualify as a *legal* object. This entails that the object has to satisfy some or other need of a legal subject.[47] Legal objects can thus have patrimonial value (in other words economic or material value) or mere sentimental (non-patrimonial) value.[48] This distinction is particularly important in seeking to elucidate the meaning of "property", since it is usually only those legal objects (with their corresponding subjective rights) with patrimonial value that are regarded as "property".[49] It follows that personality rights are generally not regarded as "property", since the legal objects of these rights (being aspects of a natural person's personality, such as a person's dignity) do not have patrimonial value. However, there is support for the view that things[50] and performances[51] do not in all instances have patrimonial value.

The word "right(s)" is not consistently used to refer to a person's subjective rights.[52] It is, for example, sometimes also used in order to refer to the powers or *entitlements* that the holder of a subjective right has to deal with a legal object by virtue of that right.

Take as example the "right" of an owner of a house to occupy the house. Ownership of the house is a subjective right (a real right). This right entails that the owner may do certain things with the house, such as use it, destroy it, possess it and dispose of it.[53] Put differently, these are entitlements which refer to how the holder of the right of ownership is legally entitled to deal with the house within the confines of her right of ownership.[54] The entitlements of the holder of a subjective right will differ depending on the kind of subjective right that she holds. For example, a landlord (who is also the owner of a house) has the entitlement to dispose of the house, whereas a lessee who leases that house does not.

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45 Badenhorst et al *Property* 23; Du Plessis *Introduction* 142 – 143 and 146 – 150

46 There is also a (less common) view that the object of a personal right is not the performance by the debtor, but the economic aspect of the debtor Refer in this regard to Van der Vyver "Private-Law Rights" in *Huldigingsbundel* 230

47 Du Plessis *Introduction* 144

48 150

49 Badenhorst et al *Property* 9 and 14; *LAWSA XXVII* para 195; "Obligations" *LAWSA XIX* para 220

50 Van der Merwe *Sakereg* 2 ed (1989) 27; Badenhorst et al *Property* 21; Van der Walt & Pienaar *Introduction to the Law of Property* 5 ed (2006) 15

51 De Wet & Van Wyk *Die Suid-Afrikaanse Kontraktereg en Handelsreg I* 5 ed (1992) 2; Van der Merwe, Van Huyssteen, Reinecke & Lubbe *Contract: General Principles* 3 ed (2006) 3

52 *Secretary for Inland Revenue v Kirsch* 1978 3 SA 93 (T) 94; Van der Vyver "Private-Law Rights" in *Huldigingsbundel* 215; Du Plessis *Introduction* 136 – 137

53 Badenhorst et al *Property* 93; Du Plessis *Introduction* 146

54 Van der Vyver "Private-Law Rights" in *Huldigingsbundel* 217

5 2 1 Real rights as "property"

A "real right" is a right to a thing, which is in turn defined as an independent corporeal object susceptible to legal control. The object must be valuable and useful to a person.[55] Examples of real rights are ownership and the rights of a pledgee in respect of the pledged thing. It is uncertain under South African law whether mere possession of a thing is a real right.[56] Suffice it to say that possession is often one of the entitlements that flows from (other) rights. It is thus an entitlement flowing from *inter alia* an owner's real right of ownership or from a lessee's personal right in terms of a contract of lease.[57]

5 2 2 Personal rights as "property"

Personal rights[58] are a person's rights to a performance, which is "an act in the form of delivering something, doing or not doing something (*dare*, *facere* or *non facere*) which one person can require a particular other person to perform".[59] One of the sources of personal rights is contract.[60] Upon conclusion of a valid contract, one or more obligations arises. Each such obligation is comprised of a passive side (being the duty of the one party, the debtor, to perform) and an active side (being the personal right of the other party, the creditor,[61] to the performance).[62]

5 3 Meaning of "property" in respect of "gross income"

Once it is accepted that only property can be an amount for purposes of the definition of "gross income", the next question that warrants consideration is what is meant by "property" in the context of income tax. As explained earlier, the word has a different meaning depending on the context in which it is used.

In *Commissioner for Inland Revenue v Estate Crewe,*[63] Watermeyer CJ said the following in respect of "property" for purposes of estate duty:

> "One would expect that when the estate of a person is described as consisting of property, what is meant by property is *all rights vested in him which have a pecuniary or economic value*. Such rights can conveniently be referred to as *proprietary rights and they include* jura in rem, *real rights, such*

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55 See 5 2 above regarding what this requirement entails

56 For a short discussion of this debate, see Badenhorst et al *Property* 273 – 275 and Van der Merwe *Sakereg* 91-92 See also Van der Vyver "Private-Law Rights" in *Huldigingsbundel* 216, who does not regard possession as a real right, but as an entitlement, and notes that the right to claim possession could be a personal right

57 Van der Merwe *Sakereg* 111

58 Also "creditors' rights" See Van der Vyver "Private-Law Rights" in *Huldigingsbundel* 232 on the different terminology

59 Badenhorst et al *Property* 23 Refer also Van der Merwe et al *Contract* 2-3; De Wet & Van Wyk *Kontraktereg* 1

60 Van der Merwe et al *Contract* 5-6 For a discussion of what is meant by a "contract", see Van der Merwe et al *Contract* 8-9

61 There may, of course, be multiple creditors and/or debtors

62 *Oertel v Direkteur van Plaaslike Bestuur* 1983 1 SA 354 (A) 370; Van der Merwe et al *Contract* 2-3; *LAWSA XIX* para 218

63 1943 AD 656

as rights of ownership in both immovable and movable property, and also jura in personam *such as debts and rights of action*."[64]

This definition of "property" thus echos the traditional view of property as a person's subjective patrimonial rights.

In *Stander's* case,[65] Friedman JP, after finding that this statement applies to all fiscal legislation, limited "property" in the context of income tax to limited "rights which have a *monetary value in the hands of the holder*".[66] The Court thus held that if a taxpayer becomes entitled to a right which she cannot turn into money, that right does not constitute "property" and is thus not "gross income". However, this limitation was rejected by Cloete JA in *Brummeria*.[67]

Based on the authority cited above, it can be argued that "property" in the limitation context of income tax legislation bears its traditional meaning, namely subjective rights with (objective) patrimonial value.

6 Loan for consumption

The nature of a monetary loan and, specifically, the subjective rights that arise in terms of such a contract, now has to be considered.

A contract for lending money is a loan for consumption or *mutuum*, which entails the delivery of units of a fungible thing to the borrower, who becomes the owner of those units, and is obliged to return the same number of units of the type of thing that was borrowed, after the lapse of time.[68]

The South African loan for consumption has its roots in Roman law, where the contract of *mutuum* was regarded as a real contract.[69] This meant that a *pactum de mutuo dando* (an agreement to lend) was not enforceable on its own. It was only once *datio*– transfer of ownership of the borrowed object(s) to the borrower– had taken place, that the contract of *mutuum* became enforceable. In light of this, *mutuum* gave rise to only one obligation, namely the obligation to return objects of the same kind, quantity and quality at expiry of the loan.[70]

Initially, *mutuum* was used for short-term loans between friends and there was thus no need to charge interest. However, over time the need arose to use *mutuum* for commercial purposes and to charge interest. If such an obligation to pay interest was to be imposed, it had to take place by virtue of a verbal contract, namely a *stipulatio*. The *stipulatio* as contract was separate from that of *mutuum*.

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64 667 Emphasis added

65 1997 3 SA 617 (C)

66 622 Emphasis added

67 Para 15 For a discussion of this aspect of the case, see Cilliers 2007 *The Taxpayer* 184 According to Van der Walt et al *Introduction to the Law of Property* 15, the value of property is generally regarded objectively

68 W*estern Bank Ltd v Registrar of Financial Institutions* 1975 4 SA 37 (T) 43; "Loan" *LAWSA XV* paras 252 and 268

69 Another form of a money-lending contract, *nexum*, was also initially available under Roman Law Under this formal contract, the debtor gave himself as hostage to the creditor for payment of the debt If the debtor defaulted, the creditor could *inter alia* enslave him or even execute him Not surprisingly, it fell into disfavour and disappeared Thomas, Van der Merwe & Stoop *Historical Foundations of South African Private Law* 2 ed (2000) 269

70 Zimmermann *The Law of Obligations: Roman Foundations of the Civilian Tradition* (1990) 153-154; Thomas et al *Historical Foundations* 269-270

In modern South African law, a loan for consumption is arguably not a real contract anymore, but rather a consensual one.[71] Once the loan contract has been validly concluded, it gives rise to obligations on the side of both the lender and the borrower. The first obligation relates to the obligation to transfer the loan capital. This entails, on the passive side of the obligation, that the lender is under a duty to give both possession of, and title to, the loan capital to the borrower.[72] On the active side of the obligation, the borrower has the right to receive possession of, and title to, the loan capital. Thus, on transfer of the loan capital, the borrower becomes the owner[73] of the loan capital and has all the usual entitlements associated with ownership:[74] She may consume it, part with it, *et cetera*.

In *Cactus Investments (Pty) Ltd v Commissioner for Inland Revenue*[75] it was held that the lender's only duty was the one described above. In particular, the SCA was of the opinion that the lender has no continuous duty to keep the loan capital available during the period of the loan. On the active side of the obligation, this means that the borrower only has a contractual right to receive possession and title to the money lent. Her "right" (or rather entitlement) to retain and use the loan capital is not derived from a continuous contractual obligation, but from her ownership of the loan capital.

The second obligation flowing from a monetary loan entails the borrower's duty to return, at the expiry of the loan period, an amount equal to the loan capital, with the lender's corresponding right to receipt thereof.[76]

Modern loan contracts often give rise to a third obligation, namely the obligation to pay interest.[77] Despite such an obligation being commonplace, it is not one of the *essentialia* of a loan contract.[78] It has been said that an interest-free loan constitutes a "continuing donation" of the interest.[79] However, it is doubtful whether this is correct in those cases where the parties never contracted that interest would be charged. Although a donation at common law includes the waiver of a right, there can be no waiver, and thus no donation, if no right existed in the first place.[80]

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71 Thomas et al *Historical Foundations* 272, *LAWSA* XV para 253, discussed in Zimmermann *Obligations* 165 n 66

72 *LAWSA XV* para 272

73 "Loan capital" in this context does not refer to coins and notes only, but may also refer to, for example, a bank account In such a case, the "loan capital" will not be a thing and it is problematic to talk of "ownership" thereof However, for the sake of convenience, this is done throughout this paper

74 *Welkom Bottling Co (Pty) Ltd v Belfast Mineral Waters (OFS) (Pty) Ltd* 1968 2 SA 61 (O) 64, *Cactus Investments (Pty) Ltd v Commissioner for Inland Revenue* 1999 1 SA 315 (SCA) 321 and *Commissioner for Inland Revenue v Genn & Co (Pty) Ltd* 1955 3 SA 293 (A) 301 See also *LAWSA XV* para 272

75 1999 1 SA 315 (SCA)

76 *LAWSA XV* para 273

77 See Cilliers 2007 *The Taxpayer* 187-188 for the different ways in which the obligation to pay interest is sometimes described

78 *NBS Boland Bank Ltd v One Berg River Drive CC; Deeb v ABSA Bank Ltd; Friedman v Standard Bank of SA Ltd* 1999 4 SA 928 (SCA) paras 17 and 18; *LAWSA XV* para 252

79 *Commissioner for Inland Revenue v Berold* 1962 3 SA 748 (A) 753F-G; *Commissioner, South African Revenue Service v Woulidge* 2002 1 SA 68 (SCA) para 10 The SCA in *Brummeria* para 12 also referred to *Berold*'s case

80 *Coronel's Curator v Estate Coronel* 1941 AD 323 The first two cases mentioned above dealt with s 7(3) of the Income Tax Act 58 of 1962, which seeks to tax the founder of a trust if she has made a "donation, settlement or similar disposition" to the trust It is arguable that an interest-free loan is a "disposition" that may in any event trigger s 7(3) Refer in this regard to the judgement by Davis J in *Commissioner, South African Revenue Service v Woulidge* 2000 1 SA 600 (C) where he held, at 610, that the failure to charge interest was a "disposition"

7 The argument in *Brummeria*

It will now be considered whether the taxpayers in *Brummeria* did indeed acquire any property that could be included in their gross income. It must be remembered that the Commissioner argued that the "benefit of the rights to interest-free loans" for the relevant periods constituted a "right which had an ascertainable monetary value and which accrued to the companies".[81]

In rejecting the Commissioner's argument, Goldblatt J stated the following:[82]

> "The 'rights' which the Commissioner alleges the appellants obtained are not rights which can be transferred or ceded. The only right which the appellants obtained was the right to retain the money lent until the happening of certain predetermined events. This 'right' has no independent existence separate from the actual liability to repay the monies borrowed and clearly has no money value."

On the other hand, Cloete JA held that "the right to retain and use loan capital for a period of time, interest-free", had an objective value and thus constituted an *amount* that accrued to the taxpayer companies.[83] In response to the above statement by Goldblatt J, Cloete JA held:[84]

> "The Tax Court also held that the benefit[85] included by the Commissioner in the companies' gross incomes had no existence independent from the liability to repay the monies borrowed; that it could not be transferred or ceded; and that it 'clearly has no money value'. This reasoning loses sight of the fact that if a right has a money value– as the right in question did, for the reasons I have given– the fact that it cannot be alienated does not negate such value."

It is submitted that Goldblatt J's reasoning is to be preferred to that of Cloete JA. In advancing this argument, the phrase "the right to retain and use loan capital for a period of time, interest-free", which was used by the SCA to describe the amount that was "gross income" of the taxpayers, will be analysed in order to determine whether it refers to *property* that *accrued* to or *was received* by the taxpayers.

7 1 The right to transfer of the loan capital and the transfer of the loan capital

Upon conclusion of a loan contract, the borrower becomes the holder of a *right* to transfer of the loan capital.[86] This is a personal right and property of the borrower. When the lender discharges her duty by transferring ownership in and possession[87] of the money, the borrower becomes the holder of the real right of ownership, which is also property.[88]

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81 Para 9 of the SCA judgement
82 Para 13 of the Tax Court judgement
83 Para 12 of the SCA judgement
84 Para 19 of the SCA judgement
85 Note that Goldblatt J did not use the word "benefit", but rather "'the rights'"
86 See 6 above
87 Often, of course, the lender will discharge her duty by way of electronic transfer, rather than delivering coins and notes In such an event, it is problematic to refer to "possession" of the money See also n 17 above
88 Arguably, both the personal right and the real right of ownership have patrimonial value

However, as explained earlier, not every acquisition of physical control over money or money's worth constitutes a receipt for purposes of the definition of "gross income". It was accordingly held in *Commissioner for Inland Revenue v Genn & Co (Pty) Ltd*[89] that in the case of a loan, the loan capital is not regarded as being "received" by the borrower, since at the exact moment that she obtains possession of the loan capital, she is placed under a simultaneous duty to repay it. The fact that the borrower becomes the owner of the loan capital does not change this.

Genn's case was not considered by the SCA in *MP Finance Group CC v Commissioner for South African Revenue Services*.[90] In that case the appellant was obliged to repay money that was obtained from investors under an illegal pyramid scheme. The Court considered the meaning of the word "receive" in the context of the illegality of the investments and held that such money was "received" by the appellant, even though it was under an obligation to repay the money due to the illegality of the investment.[91] The Court, however, did not consider the meaning of the word "receive" in the context of the argument that the investments were *loans* and *Genn*'s case was thus never discussed.[92] Accordingly, this case does not overrule the principle in *Genn* in respect of the receipt of loan capital. Furthermore, since the principle in *Genn* was accepted by the SCA in *Brummeria*,[93] which was decided after *MP Finance Group CC*, it must be accepted that *Genn*'s principle is still applicable in respect of loan contracts.

Although *Genn*'s case specifically excludes acquisition of the loan capital as a "receipt", there is little doubt that the acquisition by the borrower of the right to receive transfer of the loan capital will, for the same reason, not be regarded as an "accrual".[94] Thus it was held in *ITC 1778*[95] that an interest-free loan made to the taxpayer did not *accrue* to the taxpayer. More generally, it was held in *Commissioner for Inland Revenue v Felix Schuh (SA) (Pty) Ltd*[96] that a "loan" does "not figure in … the computation of the respondent's *receipts and accruals*".[97]

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89 1955 3 SA 293 (A) 301

90 2007 5 SA 521 (SCA) *Genn*'s case was, however, considered in the Tax Court judgement of that same case reported as *ITC 1789* 67 SATC 205

91 Para 11

92 See para 7 where the possibility was raised that the investments were loans See also *ITC 1789* 67 SATC 205 where the tax court expressly limited *Genn*'s case to *loans*.

93 Para 9 of the SCA judgement

94 See O'Donovan "Receipts, Accruals and Double Taxation" 1969 *SALJ* 278 where the author queries whether, in light of *Genn*'s case, "receipts" as an independent basis of assessment is still a possibility, since a taxpayer would invariably become entitled to an amount (in other words it will accrue to her) either before or simultaneously with receipt of the amount But see "Are Income Receipts Taxable" 1971 *The Taxpayer* 225 225 where the author is doubtful as to whether this will always be the case See further *ITC 1789* 67 SATC 205 confirmed by the SCA in *MP Finance Group CC v Commissioner for South African Revenue Services* 2007 5 SA 521 (SCA) The reasoning in the latter two cases is criticised in Meyerowitz "Receipts or Accruals: Two Independent Concepts?" 2007 *The Taxpayer* 181 – 184

95 66 SATC 334 para 46

96 1994 2 SA 801 (A)

97 812 Emphasis added

Genn's principle was accepted by both the Tax Court[98] and the SCA[99] in *Brummeria*. It is therefore clear that the "right to retain and use loan capital, interest-free" does not refer to either the borrower becoming entitled to transfer of the loan capital, or the actual receipt of the loan capital.

7 2 The "right" not to pay interest

As noted above,[100] charging interest is not one of the *essentialia* of a monetary loan. A lender will only have a right to interest if the parties agreed thereto. In the absence of such agreement, it would be fallacious to state that the lender has a duty not to charge interest, or, conversely, that the borrower has the "right" not to pay interest. The "benefit" of not having to pay interest is neither a personal right nor any other form of property.[101] It thus cannot constitute an *amount* for purposes of the definition of "gross income", irrespective of whether or not it has value.[102]

7 3 The "right" to retain and use the loan capital

The last question that has to be considered is whether the "right" to use and retain the loan capital is *property* that *accrues to*[103] the borrower.

As explained earlier,[104] the lender's only duty under a loan contract is to transfer possession of, and title to, the loan capital to the borrower. Importantly, the lender does not have a continuous contractual duty to make the loan capital available (nor does the lender have any other continuous contractual duties). Conversely, the borrower does not have a continuous personal right to retain and use the loan capital. This "right" merely refers to entitlements of the borrower by virtue of her right of ownership of the loan capital. As already mentioned,[105] the borrower becomes the owner of the loan capital and thus enjoys all the usual entitlements of an owner, including the entitlements to possession and use.

The borrower becomes owner of the loan capital and holder of these entitlements upon transfer of the loan capital. However, for the reasons set out above,[106] this event is not recognised as an *accrual* or receipt for purposes of

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98 Para 15 of the Tax Court judgement Goldblatt J held that the obtaining of the loan capital by the borrower is a receipt, but not "gross income" since it is of a capital nature As support for his view, he refers to *Genn*'s case However, it seems that the reasoning in *Genn's* case was not based on the argument that the loan capital was capital, but rather that the borrower did not "receive" it

99 Para 9 of the SCA judgement

100 See 6 above

101 Goldblatt J clearly did not consider this to be a subjective right See para 6 of the Tax Court judgement where he referred to it as a "benefit" and para 13 where he put the word "rights" in inverted commas Compare this on the other hand with Cloete JA's judgement where he referred to it interchangeably as a "right" and a "benefit"

102 For a contrary view, compare Meyerowitz *Meyerowitz on Income Tax* 2006-2007 ed (2007) para 6 47

103 Since there cannot be physical control over this "right", it arguably cannot be *received by* the borrower In the discussion below, only the possibility of an *accrual* of this right will thus be discussed

104 See 6 above

105 6 above

106 7 1 above

the definition of "gross income". Moreover, no other event takes place that can be regarded as an *acquisition* (accrual) of *property* in the form of a *right* (an amount) by the borrower.[107] In other words, neither the accrual, nor the amount, requirement for "gross income" is met.

Had a lender been under a continuous contractual duty, there might have been room for an argument that the borrower acquired a personal right against the lender on a continuous basis and that there was thus an *accrual* of an *amount* (assuming such personal right would have had objective monetary value) on a continuous basis. However, as has been repeatedly argued in this paper, the lender has no such continuous duty.

The argument that there was no *acquisition* of a *right* after transfer of the loan capital was also the basis of Goldblatt J's reasoning in the Tax Court. At several places in his judgement he makes it clear that the entitlement to use the loan capital is not a distinct subjective right that accrued to the taxpayers. Had the taxpayers used the loan capital to produce non-capital accruals or receipts, these could amount to "gross income". But they had not. He thus held as follows:

> "[T]he appellants were entitled to use the monies received by them [for income-producing purposes] … [T]he monies were not used for these purposes and the Commissioner has assessed them on the basis of *notional income* received from the use of this money. This clearly is not permissible and such *notional income* is not income within the definition of s1 of the Act."[108]

And:

> "What is of value [to the borrower] is the *possession of the money* borrowed. Possession of money cannot in itself earn income as it is merely an income producing tool which may be used by the possessor to earn income but need not be so used. What the Commissioner has attempted to do is to treat the opportunity to earn income as income. This merely has to be stated to be rejected as not falling within the definition of 'gross income'."[109]

Also at para 15:

> "If a contractual aspect of such a loan [*ie* that no interest is charged] makes it less or more valuable to the borrower, either at the date advanced, or at a later date, this simply affects the potential utility of this capital receipt in his hands, but does not in itself *increase or decrease his gross income*."[110]

The SCA never dealt with the issue as to how the "right" to retain and use the loan capital can be regarded as *property* that was *acquired by* the taxpayers after receipt of the loan capital in any great depth. Instead, once the Court concluded that this "right" had objective monetary value, it simply accepted that it was an *amount* that accrued to the taxpayers on a seemingly continuous basis.[111]

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[107] That is, unless the loan capital is used to generate further receipts and accruals

[108] Para 12 of the Tax Court judgement Emphasis added

[109] Para 13 of the Tax Court judgement Emphasis added

[110] Emphasis added See Brincker *Taxation Principles of Interest and Other Financing Transactions* 4 ed (2007) A-9 for a short discussion of this paragraph

[111] Based on the fact that an amount was included in the taxpayers' gross income on a yearly basis, it must be accepted that the "right" to retain and use the loan capital accrued (and would carry on accruing) on a continuous basis throughout the term of the loan

The SCA dealt with Goldblatt J's argument as follows:

> "The Tax Court held that the companies received no monies on loan which were used to produce any income, and that the Commissioner had therefore assessed the companies on notional income…. The Commissioner taxed the companies on the basis of the *benefit* consisting in the right to use the loans without having to pay interest on them. That benefit remained, whatever the companies did or did not do with the loans. Furthermore, no question of double taxation would arise, as suggested on behalf of the companies, if the amounts lent were to have been invested so as to produce interest – in such a case there would be *two separate and distinct receipts or accruals*, each of which would fall to be included in the companies' gross incomes."[112]

However, this statement does not explain *how* the benefit accrues, *ie* on what basis it can be said to be (continuously) *acquired*. It also does not explain how this "benefit", which is not property in itself, can be an *amount*.[113] For these reasons, Goldblatt J's argument is to be preferred.

7 4 The right to occupy a property for free

Lastly, notice should be taken of the following statement by Hefer JA in *Commissioner for Inland Revenue v People's Stores (Walvis Bay) (Pty) Ltd*:[114]

> "The first and basic proposition is that income, although expressed as an amount in the definition, need not be an actual amount of money but may be 'every form of property earned by the taxpayer, whether corporeal or incorporeal, which has a money value including debts and rights of action…' This proposition is obviously correct … It is hardly conceivable that the legislature could not have been aware of, or would have turned a blind eye to, the handsome profits often reaped from commercial transactions in which money is not the medium of exchange. Consider eg the many instances of valuable property changing hands, not for money, but for … *remuneration for services in the form of free or subsidised housing* … These are only a few of the many possible illustrations that readily come to mind and which, as we know, have not been overlooked by the legislature."[115]

The question is whether the phrase emphasised above provides support for the argument that if an employee's right to free housing may constitute "gross income" of the employee, then a borrower's right to borrow money interest-free may similarly be regarded as "gross income" of the borrower. Such an argument would overlook an important distinction between an interest-free monetary loan and a right to occupy a property at no consideration, as explained below.

The contract to provide free accommodation can probably be classified as an *innominate* contract.[116] In terms of such a contract, ownership of the property is not transferred to the employee.[117] Instead, the employee's entitlement to occupy arises by virtue of her *personal* right against the other party.

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[112] Para 18 of the SCA judgement Emphasis added

[113] See also the argument by Cilliers 2007 *The Taxpayer* 188 that based on the SCA judgement double taxation is, at least economically, a real problem

[114] 1990 2 SA 353 (A)

[115] 363I-364C Emphasis added

[116] The employee is obliged to give a counter-performance, being the rendering of services, in return for free housing In *De Jager v Sisana* 1930 AD 71 and *Jordaan NO and Another v Verwey* 2002 1 SA 643 (E) it was held that such an arrangement would not be classified as a lease (since the employee's counter-performance is not in the form of payment of money or fruit), but rather as an *innominate* contract For a discussion of these cases, see Kerr *The Law of Sale and Lease* 3 ed (2004) 262 – 270

[117] Although these arrangements are not "leases" as discussed above, they share a number of similarities with lease contracts It should be noted that a lessee usually does not have real rights in respect of the leased property But see Badenhorst et al *Property* 430 – 431 for some exceptions to this usual position

An important distinction between a monetary loan and this type of *innominate* contract is that the counter-party has a continuous contractual obligation, whereas a lender only has a passing obligation.[118] The employee thus becomes continuously entitled to the personal right against the counter-party. Provided that this right is of a non-capital nature and has objective monetary value, it is arguably an *amount* that *accrues* to the employee on a continuous basis.[119]

Finally, it should be borne in mind that even before the enactment of the Seventh Schedule to the Income Tax Act,[120] which deals with fringe benefits, income in respect of employment services was defined more widely than other forms of income. For example, in the 1917 Act[121] "gross income" was defined as "the total amount received by or accrued to or in favour of any person …and includes …the estimated annual value of any quarters or board or residence or any *other benefit or advantage* of any kind granted in respect of employment, whether in money or otherwise…".[122] The role of legislation as regards tax benefits received in respect of employment is also specifically acknowledged by Hefer JA's words "have not been overlooked by the legislature" at the end of the paragraph from *People's Store* quoted above.[123]

8 Future application of the SCA judgement

There is little doubt that the SCA decision will apply to similar benefits arising from other interest-free loans, provided of course that they are of a non-capital nature. This proviso will exclude these benefits in the majority of cases. In other cases, the taxpayers may try to challenge aspects (of similar scenarios) not considered in the *Brummeria* case by, for instance, advocating the adoption of a particular method of valuation.

But of even greater significance is the possibility that the SCA decision may find application beyond interest-free loans. One such area is employment benefits that are not taxable under the Seventh Schedule. There may be a risk that these (non-capital) benefits could now be taxed under paragraph (a) or (c) of the definition of "gross income", even if they do not represent *property* of the employee. In this regard, Cloete JA said:

> "[The seventh schedule] was inserted into the Act not because [fringe] benefits *are not otherwise taxable*, but to put beyond doubt what benefits are taxable and, equally importantly, to determine how their value is to be assessed for the purpose of calculating the tax to be deducted by an employer from an employee's remuneration".[124]

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[118] In the same manner in which a lessor has the continuous duty to provide undisturbed use See "Lease" *LAWSA XV XIV* para 161 in respect of this duty The Appeal Court also made this distinction between a lease and a monetary loan in *Cactus Investments (Pty) Ltd v Commissioner for Inland Revenue* 1999 1 SA 315 (SCA) See also *LAWSA XIX* para 227 for the distinction between passing and continuous obligations

[119] The initial transfer of possession of the leased thing is not regarded as a "receipt" Refer in this regard to the *(obiter)* view of the Appeal Court in *Commissioner for Inland Revenue v Genn & Co (Pty) Ltd* 1955 3 SA 293 (A) 301

[120] Act 58 of 1962

[121] S 6 of Act 41 of 1917

[122] Emphasis added

[123] See, however, para 17 of the SCA judgement in this regard

[124] Para 17 of the SCA judgement Emphasis added

9 Conclusion

The SCA in *Brummeria* held that "the right to retain and use the loan capital, interest-free" was a valuable right that accrued to the taxpayers and formed part of their gross income. In reaching this decision, the SCA accepted the principle in *Lategan* and *People's Store* that "every form of *property*" of a non-capital nature that is *acquired* or received by a taxpayer, constitutes gross income.

Yet the Court never (expressly) considered whether this particular "right" was indeed susceptible to classification as *property,* or whether it was *acquired* on a continuous basis throughout the duration of the loan. Rather, once it had decided that this "right" had objective monetary value, the SCA simply accepted that this meant that all the requirements[125] for "gross income" had been met.

The SCA judgement creates a possibility that, in future, it could be contended that any *benefit*, irrespective of whether or not it is *property*, could constitute an *amount*. What such a "benefit" may entail (apart from the fact that it must have objective economic value) is not explained in the judgement, leading to considerable uncertainty. If this analysis is correct, the decision by the SCA in *Brummeria* may indeed be the most important tax case in the past 30 years.

SUMMARY

In *Commissioner, South African Revenue Service v Brummeria Renaissance (Pty) Ltd* 2007 6 SA 601 (SCA) the Supreme Court of Appeal held that when an interest-free loan is made, the "right" to retain and use the loan capital interest-free constitutes an *amount* which *accrues* to the taxpayers and forms part of their "gross income" for purposes of the Income Tax Act 62 of 1958 (if it is of a non-captial nature). In response to this judgement, it is argued that only *property* accruing to a taxpayer is capable of constituting such an amount, and of thus forming part of gross income. Furthermore, it is submitted that the "right" to use the loan capital on an interest-free basis cannot be equated with "property" that is acquired by the borrower during the currency of the loan. Such a "right" can thus not be said to constitute an *amount*, and it follows that it cannot *accrue* for purposes of the Act's definition of "gross income".

[125] As explained, the non-capital nature of the "right" was never in issue