IN THE HIGH COURT OF SOUTH AFRICA
CAPE OF GOOD HOPE PROVINCIAL DIVISION

CASE NO : A967/05

In the matter between :

THE COMMISSIONER FOR THE
SOUTH AFRICAN REVENUE SERVICE
Appellant

and

G H HIGGO Respondent

JUDGMENT DELIVERED THIS 18TH DAY OF AUGUST, 2006

FOXCROFT, J : This is a Full Bench Appeal against the judgment of the Special Court delivered in this matter on 30 August, 2005, upholding the Respondent's objection to income tax assessments. For the years of assessment dated 28 February 2001 and 2002 he had submitted returns of his income wherein he –

(a) indicated the receipt of certain income from Momentum Life Ltd;
(b) sought to deduct the following '*management fees*' as deductions from his income mentioned in (a) above :

2001 - R58 027,24
2002 - R55 809,10

The Commissioner, however, in the determination of the Appellant's taxable income for the said years of assessment, disallowed and added back the '*management fees*' aforementioned and on this basis issued assessments for normal tax on the Appellant for those years of assessment.

The Commissioner's attitude was that Respondent was subject to tax on the basis that amounts paid to him in terms of his contract with Momentum Administration Services ("Momentum") constituted annuity payments and thus gross income in terms of paragraph (a) of the definition of gross income in section 1 of the Income Tax Act, No 58 of 1962. Respondent contended that the proper construction of his contract with Momentum is that Momentum administered capital on behalf of Respondent and that he was assessable only on so much of the payments as constituted taxable income derived from the investment.

Respondent succeeded in the Special Court and the Commissioner has appealed to this Court.

There were two preliminary questions. The first was an application for condonation of the late filing of the Record on appeal by Appellant, which

was supported by an affidavit from Mr Jorge, an employee of the SA Revenue Service and by Mr Wilken, an attorney in the office of the State Attorney, Cape Town. In short, Mr Jorge deposed to the fact that he despatched by courier to the State Attorney, Cape Town on 16 March 2006, the Record of the appeal for service the following day, the last day for filing. Unfortunately, the State Attorney did not receive the Record by 17 March, but only on 20 March, and he immediately attended to the service and filing of the Record on its receipt.

Mr Wilken confirms this information, and commendably took steps on 17 March to record that he had not yet received the Record and would do so as soon as it arrived.

Mr *Meyerowitz,* who appeared for Respondent, did not oppose condonation of the late filing, but suggested that the Court should voice its displeasure at the tardiness of Appellant in waiting until the day before the Record was due to be filed before attending to the matter. The criticism is justified and while condonation will be granted, the Appellant is enjoined to ensure that the records in tax appeals on the Commissioner's behalf are compiled by the staff of the Registrar of the Tax Court in a more expeditious

manner. That will remove the necessity for, and the cost of, applications for condonation.

The next preliminary matter was an application that facts set out in three affidavits be received as further evidence on appeal. It was acknowledged in the affidavit of Mr Jorge that the case was argued in the Special Court on the basis of undisputed facts set out in a final minute dated 11 August 2005. [Record, 140-145]. Mr Jorge then adds that

> *"The appellant was represented in the special court by in-house legal counsel."*

The affidavit continues to explain that appellant briefed 'external counsel' to represent him in the appeal to this Court, and in December 2005

> *"counsel drafted the notice of appeal but at the same time advised that it might be desirable to supplement the facts contained in the minute. He raised certain matters for investigation and clarification."*

It appears that counsel's query is related to legal process by which Respondent's pension benefit had been transferred from the Reckit &

Colman Pension Fund [*'RCPF']* to Momentum with effect from September 1998.

It is then stated that

> *"SARS was only able to furnish the State Attorney with instructions on these matters on 9 May 2006. The delay was mainly attributable to the difficulty SARS encountered in scheduling a meeting with Alexander Forbes, the pension fund consultants who had advised Reckit & Colman at the time of its conversion from a defined benefit fund to a defined contribution fund in 1998 and had assisted Reckit & Colman in the resultant transfers."*

The additional evidence sought to be placed before this Court was first, Annexure 'A' to the Rules of the RCFP dealing with the position of defined benefit members, pensioners and deferred pensioners of that fund as at 1 September 1998. Respondent in this matter was a pensioner of the RCPF at that date.

An option form presented to all pensioners in connection with the proposed conversion and transfer to Momentum was also sought to be introduced. A copy of Alexander Forbes' application dated 7 February 2001 for the

approval of the transfer of business to Momentum and the approval were also documents which Appellant wished to be added to the Record on appeal. The application claims that the question to be determined is of

> *"great practical importance in the taxation of pension benefits, and it is undesirable that confusion and uncertainty should exist or that a case such as the present one should be decided on incomplete facts."*

In paragraph 18 of his affidavit Mr Jorge goes on as follows :

> *"It appears that in the special court both parties in good faith sought to facilitate and expedite the hearing by way of agreed facts. At least on SARS' side, however, there appears to have been an error in judgment as to the sufficiency of those facts."*

The second affidavit in the application is signed by Mr D.A.S. Badenhorst, who confirms that an amount of R6 099 778,00 was paid by RCPF to Momentum in September 1998 in respect of Respondent. That is not in dispute and the admission of his affidavit would take the matter no further. Mr A.L.A. Raphahlela also deposed to an affidavit confirming the

correctness, at 1 September 998, of the RCPF Rules sought to be introduced into evidence.

The application to supplement the evidence on appeal was opposed by Respondent, who pointed out that it was at the instance of Appellant's in-house legal counsel that a set of facts was agreed between the parties and set out in the final minute presented to the Special Court. He stated further that

> *"Apart from the Dossier, no other evidence was adduced by the parties. The matter was in effect decided as a stated case."*

He added that no reasonable explanation has been given as to why the 'new evidence' was not placed before the Special Court at the hearing of the matter. He is correct in adding that it is

> *"clearly evidence that was easily obtainable at the time."*

Mr Rogers, who appeared for Appellant, attempted to persuade us that no prejudice would be caused to Respondent if the further factual information sought to be included were allowed. He stressed that this case turned on a legal question to which these facts were secondary. He submitted that he was not attempting to introduce a new case on the facts, but only adding certain additional facts which did not substantially alter the factual framework upon which the legal question had to be decided.

In my view, the resistance to this application raised by *Mr Meyerowitz* was well founded. He submitted that there is no relationship between the pension provisions of the Pension Fund and the contractual terms entered into between Respondent and Momentum. The new material was therefore irrelevant and for that reason alone, *Mr Meyerowitz* submitted, it should not be admitted.

In my view, counsel was also correct to point out that, in general terms, the Appellant had not shown any sufficient reason why the evidence which was available at all times to SARS was not proffered for inclusion in the agreed statement of facts concluded in the Special Court. It is perhaps not surprising that there appears to be no decided case or authority for

permitting an appeal court to add to the agreed facts on which Appellant and the taxpayer argued a dispute in the Special Court. In my view, this is in the nature of a stated case and any alteration to the facts agreed upon in a stated case must amount to an attempt to bring a new case. The appeal before us is against the decision on the agreed case, and it would seem to me to be totally incompetent for an appeal to be heard on an agreed case supplemented by new and disputed factual material, which was not before the Special Court.

The application to adduce further evidence on appeal is accordingly dismissed with costs.

THE MAIN ARGUMENT

Mr Rogers submitted that the case was dealt with in the Special Court on the basis of facts recorded in the pre-trial minute, the final draft of which was dated 11 August 2005 (Record, 140], as read with a bundle of documents. He submitted that the Special Court had erred by referring to an earlier draft which one finds at page 117 of the Record, and he drew our attention to the main differences between the two versions as identified in paragraph 1.2 of the Commissioner's notice of appeal [Record, 164-165].

Paragraph 1 of the minute makes clear that the nature of the RCPF was changed from a '*defined benefit fund*' to a '*defined contribution fund*'. Pensioners in the position of Appellant were given a choice of remaining with the fund and having their pension enhanced by a percentage arising from an actuarial surplus, or of leaving the fund subject to investing the amount payable, namely the actuarial valuation of their previous benefit plus a percentage arising from the surplus in what was termed a '*retirement income option*'. Paragraph 2 in its final form read as follows :

> "2. *The Appellant chose the latter and the said amount was transferred to Momentum Life Limited.*"

Paragraph 3 of the final minute makes clear that Momentum and not the Respondent ['*the taxpayer*'] would invest the amount on the taxpayer's behalf. There are other less important differences.

Mr Meyerowitz referred to "the ultimate agreed facts" as appearing at p.140-142 of the Record and submitted that he had annexed this ultimate

statement to his Heads of Argument in the Special Court. He submitted further that it was of no legal significance whether the Court quoted from the original draft minute in the Dossier or an earlier version, since this had no material consequence in the Court coming to the conclusion to which it did". He proceeded to submit that the issue for determination was and remained the legal effect of the contract which determines whether what became payable was an annuity or a payment out of capital, which Momentum was obliged by the contract to pay to Respondent, and after his death to his beneficiaries, until the capital was exhausted.

Mr Meyerowitz submitted that it was common cause that, on 26 August 1998, Respondent entered into an agreement with Momentum in terms on Respondent's behalf in a living annuity with Momentum with effect from 1 September 1998, which would provide Respondent with an initial income of R41 666,66 per month, the first instalment being of which Momentum would invest an amount just in excess of R6 million payable on 30 September 1998, This amount could be revised annually at the instance of Respondent subject to his being limited at the time of revision to direct Momentum to pay him monthly amounts equal to not less than 5% and not more than 20% annually of the total value of the investment on the anniversary of 1 September. The Respondent revised the monthly sum to R50 000,00.

Mr Meyerowitz submitted that the Respondent had effectively entered into an agreement for the return of his capital together with income derived therefrom until the capital had been exhausted. In other words, the Agreement envisaged a payment in instalments of a capital sum together with interest thereon.

In support of this argument he referred to the case of **DEARY v DEPUTY COMMISSIONER FOR INLAND REVENUE, 1920 CPD 541.** In that matter the Court referred to an English case, **JONES v CIR, 1920 [1] KB 611,** where the following was said :

> *"A man may sell his property for a sum which is to be paid in instalments and when you see that is the case, that is not income nor any part of it. ….. A man may sell his property for what is an annuity – that is to say he causes the principal to disappear and an annuity to take its place."*

Central to the case was the submission that the amount of R6 099 778,00 was paid by the Pension Fund to Momentum on behalf of Respondent.

The Special Court decided this case on the basis of facts recorded in a pre-trial minute which went through several drafts. The final minute dated 11 August 2005 [Record, 140] did not record that the money received by Momentum at any stage belonged to the taxpayer.

Is the fact that the taxpayer did not become the owner of the transferred sum, if that indeed is the legal position, dispositive of the fiscal question?

Mr Rogers submitted that the true position can be simply stated, namely

> *"During his employment the taxpayer and his employer contributed to the RCPF at the rates specified in the latter's rules. Because the RCPF was a defined benefit fund these contributions "disappeared", the taxpayer's only interest on retirement being the right to receive a defined pension benefit (which would bear no particular relation to the contributions paid).*
>
> *… There can thus be no doubt that the pension, for as long as it was paid by the RCPF, was an annuity.*
>
> *Because of the RCPF's conversion, the enhanced actuarial value of the taxpayer's annuity (not of his original contributions) was transferred to another retirement fund or insurer. The taxpayer did*

not, and could not legally have, become the owner of the transferred amount. …

The transfer did not change the character of the periodic payments which the taxpayer received. They remained an annuity procured by means of the contributions paid to the RCPF by the taxpayer and his employer while the taxpayer was still an in-service member of the RCPF. Those contributions had long since "disappeared" and been replaced by a right to an annuity, and the right to an annuity never ceased – only its provider changed."

Mr Rogers filed Supplementary Heads of Argument on the question of '*disappearance of capital*', which included a survey of a number of foreign cases. None is precisely in point, although the different situations with which other courts have had to deal are helpful. *Mr Rogers* laid some emphasis on the case of **ANZ SAVINGS BANK LIMITED v FCT,** a decision of the Federal Court of Australia in 1993, where a purchase of 50 million units in a trust fund for a total consideration of $50 million was held to amount to the purchase of an annuity and not to a contract of loan. At page 372 of the report in 25 ATR 369, DAVIES J said the following :

"A fundamental distinction between an annuity transaction and a loan transaction is that, when monies are lent, there is an obligation

on the part of the borrower to repay the loan. If an annuity is purchased, there is no obligation on the part of the annuity provider to repay the price paid. The obligation is to pay the agreed annuity and no relationship of debtor and creditor exists with respect to the price paid."

In the main judgment of the Court, HILL, J investigated the history of annuities and their identifying characteristics. In **FOLEY v FLETCHER, 1858 [3] H & 769; 157 ER 678,** WATSON, B said the following :

"But an annuity means where an income is purchased with a sum of money, and the capital has gone and has ceased to exist, the principle having been converted into an annuity."

HILL, J continues as follows :

"This passage has been cited with approval in virtually every case decided after FOLEY v FLETCHER, although without close analysis of what it meant by the words "the capital has gone and has ceased to exist"."

After further examination of the English cases, HILL, J said at 391 against marginal number 35 :

> *"There is good reason why the question whether a particular payment is an instalment of an annuity or part repayment of capital with interest must be determined as a matter of form, rather than substance. In every case where the term annuity is involved, the substance of the transaction will involve an investment of a capital sum by an investor to produce a return to the annuitant, calculated by reference to that capital sum to which is applied an agreed or defined percentage interest rate."*

Remembering that HILL, J was deciding whether an amount constituted a loan or an annuity, his comments at 392, marginal letter 10, shed further light :

> *"The metaphor of disappearance may perhaps be misleading, in that in one sense the moneys paid, whether as the purchase price of the annuity or as the principal sum lent, are not traced to see whether the actual bank notes remain in existence. Money is a fungible. A consequence of the transaction being a loan will be that in the event of breach the capital outstanding may be sued for in debt. Where the transaction is an annuity and there is a breach, then, but subject to the terms of the annuity, the cause of action of*

the annuitant will lie in damages for breach of the contract."

Mr Rogers submitted that similar considerations applied to the present matter. He also argued that if the underlying assets had belonged to the taxpayer and if Momentum was merely an agent to hold those assets on his behalf, there might not have been an annuity, but that that would have nothing to do with the 'disappearance of capital' principle. In such a case the taxpayer would simply have used his own money to buy units and the interest and dividends thereon would accrue to him not by virtue of a contractual right of payment against Momentum, but because he was throughout the owner of the units. He went on to submit that in the present case nothing supports the view that the taxpayer owned the underlying assets or that Momentum was his agent.

While a ***rei vindicatio*** might not be an appropriate claim in the hands of the taxpayer on the facts of this case, Momentum was not a beneficial owner of what it received from RCPF. The R6 million which it received was money it received on behalf of Respondent. In my view, it also received that money for the benefit of Respondent, although *Mr Rogers* was at pains to

differentiate between these two concepts. While he was constrained to agree - since the agreed minute said so - that the money was received on behalf of Respondent, he disputed that it was received 'for his benefit'.

In my view the money which Momentum received on behalf of Respondent was money which it was obliged to invest for the benefit of Respondent in order to carry out its contractual obligation to make periodic payments to Respondent. The money which had been transferred by RCPF to Momentum and used to purchase the "underlying assets was not merely the measure of the cash payments which Momentum was obliged to make", as *Mr Rogers* submitted, but was the guarantee for payment to him of that to which he, and after his death his dependants, were entitled.

It seems to me that the '*disappearance of capital'* test is particularly misleading in a situation such as the present. As HILL J said, money is a fungible and the actual money obviously disappears when investments are bought with that money. Throughout his life, the Respondent will be in control of the investment of his capital or the capital which was paid by

RCPF to Momentum for his benefit, whichever way one wishes to describe it. Respondent is entitled to regulate within agreed limits how much of this fund is to be paid to him annually. In a very real sense, therefore, the capital paid to Momentum on Respondent's behalf and for his benefit cannot be said to have 'disappeared'. It had to be held by Momentum to cover Momentum's obligation to Respondent until that obligation was entirely fulfilled.

In the result, it is ordered as follows :

(1) the application to adduce further evidence is dismissed with costs;
(2) the appeal is dismissed with costs.

J G FOXCROFT

DAVIS, J, : I agree.

D M DAVIS

WAGLAY, J : I agree.

B WAGLAY

****** REPORTABLE

REPORTABLE JUDGMENT

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In the matter between :

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE *Appellant*

and

G H HIGGO *Respondent*

Counsel for Appellant	:	Adv O Rogers [SC]
Instructed by	:	The State Attorney CAPE TOWN
Advocate for Defendant	:	Adv D Meyerowitz
Instructed by	:	Ince Wood & Raubenheimer
Dates of Hearing	:	26 July 2006
Date of Judgment	:	18 August 2006