IN THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

REPORTABLE

CASE NO 103/2002

In the matter between

OMNIA FERTILIZER LIMITED **Appellant**

and

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE **Respondent**

CORAM: **HOWIE P, SCHUTZ, ZULMAN, NAVSA JJA et HEHER AJA**

Date Heard: 17 February 2003

Delivered: 13 March 2003

Summary: **'Recouped' in s 8(4)(a) of Income Tax Act 58 A 1962 □ meaning of □ whether recoupment effected.**

J U D G M E N T

HOWIE P

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[1] The issue in this appeal is whether the appellant taxpayer effected a 'recoupment' within the meaning of s 8(4)(a) of the Income Tax Act, 58 of 1962.

[2] In tax years preceding 1991 the taxpayer, a fertilizer manufacturer, claimed and was allowed deductions, in terms of s 11(a) of the Act, of expenditure incurred in the production of its income. The expenditure included the purchase price of raw materials bought on credit that were necessary for the manufacture of the taxpayer's product and the transportation of such materials to the taxpayer's factory. When certain of the creditors concerned subsequently failed to claim payment, the taxpayer, in later tax years, allocated the amounts unclaimed to income. In each of the tax years 1991 to 1994 the taxpayer allocated to income the following sums representing such unclaimed debts:

1991	R2 200 000
1992	R1 600 000
1993	R1 000 000
1994	R1 935 000.

[3] In respect of each of those years the Commissioner, the respondent in the appeal, assessed the sums in question to tax. The taxpayer's ensuing objection was disallowed and its consequent appeal to the Income Tax Special Court failed. With the leave of the President of the Court (Goldblatt J) the taxpayer appeals directly to this Court.

[4] The basic facts, including those stated already, are few and uncontested. When the taxpayer received the required materials which were dispatched by road and rail it calculated the price and transport costs with which it expected to be invoiced. It then made appropriate entries in its books by debiting an expenditure account and crediting an account which showed goods 'received but not invoiced'. On receipt of invoices the latter account would be debited and the suppliers' accounts credited. If no invoices were received the taxpayer simply did not pay for the uninvoiced goods. The acquisition costs of all received materials, invoiced or not, were reflected in the taxpayer's income tax returns and, as mentioned, allowed as deductible expenditure.

[5] When, as occurred to an apparently extraordinary extent, certain creditors failed to invoice the taxpayer, half the unclaimed amounts were credited to its income account after a year and the other half after two years.

[6] The Commissioner treated the sums written back as gross income. The taxpayer's objection and its case on appeal in the Special Court were essentially founded on the contention that, having regard to the definition of 'gross income' and the wording of s 8(4)(a), its mere accounting treatment of these amounts did not, and could not, render them receipts, accruals, recoveries or recoupments within the meaning of the Act. This was also part of its argument in this Court.

[7] It is plain that once expenditure has been allowed to be deducted the overriding provision of the Act in so far as the present dispute is concerned is s 8(4)(a). Omitting irrelevant wording, it read as follows at all times relevant to the tax years in question:

'There shall be included in the taxpayer's income all amounts allowed to be deducted . . . under the provisions of sections 11 to 20, inclusive, . . . whether in the current or any previous year of assessment which have been recovered or recouped during the current year of assessment.'

[8] Accordingly, once there is recovery or recoupment of the deducted amounts they have inevitably to be included in the taxpayer's income in the year when they are recovered or recouped (cf ITC 1704 (2001) 63 SATC 258 at 262C-263A).

[9] If the proper interpretation of 'recouped' leads to a result favourable to the Commissioner, as I think it does, then it is unnecessary in this case to construe 'recovered' or to consider how these words differ in meaning.

[10] The thrust of the argument for the taxpayer in this Court is that there cannot be recoupment where the indebtedness which gives rise to an allowed deduction still exists in law. It follows that the taxpayer's prediction that it will probably never be called upon by its creditor to pay the debt is, according to the argument, therefore irrelevant, as are its accounting entries.

[11] In the present case the debts in question had not prescribed at any stage material to the litigation. For the decision of this matter, therefore, the amounts written to income must be taken to have still been subject to the taxpayer's legal liability to pay the suppliers concerned if they had demanded payment.

[12] Counsel for the taxpayer argued that recoupment should not be held to depend solely on the actions or subjective decisions of individual taxpayers, influenced by their view that payment would never be exacted. It was pointed out that in the case of accruals the Act required taxpayers to produce positive proof that they would not be paid and the least that ought to be present in the case of recoupment was, on a proper interpretation of the Act,

proof, to the same degree, that a taxpayer would never actually have to pay. I did not understand counsel, however, to seek to evade the fundamental requirement that it was for the taxpayer to show that the Commissioner was wrong in taxing the amounts written back.

[13] Although the debts here were still legally due when the sums in issue were credited to income the vital consideration in my view is that s 8(4)(a) has to do with the recoupment of amounts, not the extinction of liabilities. This indicates that the legislature contemplated that recoupment could occur despite the continuing chance that the taxpayer might after all be called on to pay. The reason for that stance would be, no doubt, that the legislature wished to ensure that if the deduction of expenditure was once allowed a taxpayer should not escape taxation if alleged expenditure was not to be expenditure after all, whether or not liability was legally terminated. Had it been intended that an amount previously allowed as deductible expenditure would become taxable only if legal liability for payment ceased to exist (whether by way of prescription, agreement or otherwise) then the legislature could have said so simply. Instead it linked taxability only to recovery or recoupment. These are words of very wide meaning, as was said in *Moorreesburg Produce Company Ltd v Commissioner for Inland Revenue* 1945 CPD 289 at 296-7.

[14] Nothing in s 8(4)(a) or its context signifies a legislative intention that 'recoup' should bear any narrower meaning than any of those which it ordinarily does. According to the Oxford English Dictionary, 'recoup' means in law

'(t)o deduct; to take off or keep back; . . . to make a deduction.'

Here, the taxpayer deducted or took off the amounts in issue from its previously declared, and allowed, expenditure and so turned such erstwhile expenditure into income. These amounts would, according to that particular meaning, therefore have been recouped.

[15] It may be as well, however, to be wary of that particular meaning because in English law (and it is that law to which the dictionary refers) it may have a particular connotation, or nuances, with which we are not familiar. (cf ITC 1704 at 263B-C.)

[16] A more common instance of the ordinary meaning of 'recoup', again according to the Oxford English Dictionary, is 'to recover what one has expended'. To get back what one has actually paid out would be a clear illustration of this meaning. The question here is whether expenditure, which by reason of taxation provisions constitutes that which is legally

owing but has not yet been paid out can, on these facts, be recouped within the meaning of the section.

[17] Where unpaid expenditure has been allowed as deduction from taxable income there is not just an expenditure entry in the taxpayer's books of account reflecting the relevant debt. There is, in addition, an assertion by the taxpayer, accepted and acted upon by the Commissioner, recognising the likelihood, if not the inevitability, that the debt will be paid. That is the basis for regarding the unpaid debts as actual expenditure. If the taxpayer later, in effect erases the debt from its books and treats the amount concerned as available for another purpose, the questions which arise are:

(a) whether the debt has for some reason ceased to exist and, if not,

(b) whether the amount unpaid, but expended in the eyes of the tax law, has nevertheless, for all practical purposes, reverted to the taxpayer's 'pocket'.

[18] As indicated, the taxpayer's argument is that an affirmative answer to (a) is essential before recoupment can occur. I disagree. A debt also ceases to exist on payment, not only when it prescribes. And if it does cease to exist before payment occurs even then there may not be recoupment until the

taxpayer takes some or other step to recoup. The crucial enquiry, therefore, is (b).

[19] There was one witness in the case, Mr WJ Prinsloo, who was the taxpayer's financial manager during the tax years in question. Clearly he spoke with abundant experience of the efficiency, or lack of it, of the creditors concerned. The patterns and regularity of their failures to invoice the taxpayer eventually enabled the latter to determine a stage in each case when, from experience and on a very conservative view, it could be said, in the words of the witness, that 'in all probabilities it is not possible' that an invoice would be received. He added that there was never an instance after an amount had been written to income that the creditor concerned demanded payment.

[20] On this evidence, therefore, the amounts in contention in this case were shown to be amounts that probably would not be actual expenditure after all. The taxpayer accordingly regarded itself as at liberty to deal with them as unexpended and for that reason credited them to income. As such, they were available for a purpose other than that for which the tax deduction had originally been allowed. In plain terms the amounts reverted to the

taxpayer's pocket. In my view, in the circumstances, the taxpayer recouped those amounts.

[21] On facts substantially comparable to those in the present case the Special Court in ITC 1634 (1997) 60 SATC 235 concluded (at 259) that by the taxpayer's having recognised that 'for all practical purposes, the unpaid liabilities had ceased to exist as such, by reason of the ineptitude of the creditors, in particular by transferring the amounts to its profit account and ceasing not only to reflect the whilom creditor as one but even to hold the amounts in suspense' the taxpayer had procured a recoupment of its expenditure.

[22] It was contended before us that that conclusion was wrong and that the Australian cases by which it was influenced did not support it. In my view it is unnecessary to analyse the Australian cases because I consider, for the reasons I have already stated, that the conclusion of the Special Court in ITC 1634 that recoupment had occurred was indeed correct. I should add that such conclusion was also approved in ITC 1704, to which I have already referred. (In the latter case, of course, the debts had prescribed and that serves to distinguish the matter.)

[23] Furthermore, assuming that the relevant entries did not in themselves effect recoupment the facts nonetheless compel the conclusion that the writing back to income constituted an admission by the taxpayer that the amounts had been recouped, by which admission, in the absence of any consideration depriving it of binding effect, the taxpayer must be bound.

[24] Finally, counsel for the taxpayer pointed to the introduction in 1997 of a new paragraph, s 8(4)(m), in terms of which, if a taxpayer is 'relieved from the obligation to make payment of any expenditure actually incurred', and a deduction has been allowed in respect of such expenditure, the taxpayer is deemed to have recovered or recouped the amount owing under the obligation. It was argued that this indicated that the legislature's intention had always been that recoupment had necessarily to involve the extinction of the obligation underlying the allowed expenditure. This contention cannot succeed. Release from indebtedness is not entailed in the ordinary meanings of 'recovered' or 'recouped'. Termination of liability is not itself a recoupment. It merely enables recoupment. If anything the new paragraph detracts from the taxpayer's argument because it signifies that ordinarily the termination of legal liability is not a requirement for recoupment. There was therefore a need for the inserted paragraph to introduce the deemed meaning.

[25] Therefore the Special Court was right in concluding that the amounts in question were recouped within the meaning of s 8(4)(a) and thus correctly taxed by the Commissioner. The appeal must fail. It is dismissed with costs, including the costs of two counsel.

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CT HOWIE
PRESIDENT
SUPREME COURT OF APPEAL

CONCURRED:

SCHUTZ JA
ZULMAN JA
NAVSA JA
HEHER AJA