REPUBLIC OF SOUTH AFRICA

IN THE TAX COURT OF SOUTH AFRICA

HELD AT MEGAWATT PARK, SUNNINGHILL, JOHANNESBURG, GAUTENG

CASE NO: 46206

(1)	REPORTABLE: ~~YES~~ / **NO**
(2)	OF INTEREST TO OTHER JUDGES: ~~YES~~ / **NO**
(3)	REVISED: **YES** / ~~NO~~

21 February 2023 ....
DATE SIGNATURE

In the matter between:

A Appellant

and

THE COMMISSIONER FOR THE
SOUTH AFRICAN REVENUE SERVICE Respondent

J U D G M E N T

THIS JUDGMENT WAS HANDED DOWN ELECTRONICALLY BY CIRCULATION TO THE PARTIES' REPRESENTATIVES *VIA* EMAIL, BY BEING UPLOADED TO *CASELINES* AND BY RELEASE TO SAFLII. THE DATE AND TIME FOR HAND-DOWN IS DEEMED TO BE 10:00 ON 21 FEBRUARY 2023.

Summary: Tax Court – section 8(4)(*a*) of the Income Tax Act – recovered or recouped amounts allowed to be deducted in previous tax years to be included in taxpayer's income – proviso to section 20(1) – assessed loss incurred in carrying on any trade outside the Republic not to be deducted from South African income – proviso not implicated if foreign assessed loss set off against income from foreign trade –

Interpretation of conflicting provisions in Income Tax Act – section 9(4)(*d*) – "foreign income" if received or accrued in respect of the disposal of an asset that is not from a source within the Republic – this section prevails over paragraph (*n*)(ii) of the "gross income" definition in section 1 – Set-off (deduction) allowed and additional assessment set aside

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ADAMS J (ACCOUNTANT MEMBER *ET* COMMERCIAL MEMBER CONCURRING):

[1] We have before us an appeal by the appellant ("the taxpayer") in terms of section 107 of the Tax Administration Act ("the TAA"),[1] against the additional assessment of the taxpayer by the respondent ("the Commissioner") pertaining to her income tax for the 2018 tax year of assessment, during which year the taxpayer emigrated (for purposes of both exchange control and tax) to the United Kingdom with effect from 3 September 2017. During that year, the taxpayer "recouped" an amount of R67 995 991 arising from a foreign trade and the said amount was included in her gross income for that year. The taxpayer contends that she was entitled to set off, against that foreign trade income, a brought forward assessed loss of R62 296 925 arising from that self-same foreign trade in prior years.

[2] In essence, the effect of the additional assessment was that the taxpayer's taxable income for the 2018 tax year of assessment did not take into account the deduction of R62 296 925, being an assessed loss brought forward from the 2017 tax year. The taxpayer was accordingly taxed on an income substantially more than what she believed the total amount of her income for that year to have been. The South African Revenue Service ("SARS"), so the taxpayer contends, wrongly disallowed the set-off claimed, thus subjecting her to income tax on the full amount of the recoupment, being R67 995 991, rather than on only R5 699 066 thereof, being the net amount after set-off of the assessed loss.

[3] The fundamental issue in dispute in this appeal is whether the taxpayer may in terms of section 20(1) of the Income Tax Act ("the ITA"),[2] set off (deduct) the balance of the foreign assessed loss from an aircraft partnership trade, as carried forward to the 2018 tax period, against the income received by or accrued to her in the form of recoupments arising from the deemed disposal, under section 9H of the ITA, of partnership assets used in the conduct of a

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1 Tax Administration Act, 2011 (Act No. 28 of 2011).
2 Income Tax Act,1962 (Act No. 58 of 1962).

foreign trade. The dispute turns on the source (for purposes of proviso (*b*) to section 20(1)) of the recoupment income included in the taxpayer's 2018 year of assessment arising from the deemed disposal of the aircraft.

[4] The adjudication of the aforesaid dispute between the parties requires a proper interpretation of section 20(1) of the ITA, as well as the erstwhile sub-paragraph (*n*)(ii) of the definition of "gross income" in section 1 of the ITA. This sub-paragraph was in the ITA as and at the date of the appellant's emigration during September 2017, although it was subsequently repealed. The appellant and the Commissioner, in applying these provisions to the facts in this matter, place different interpretations on these provisions and it may be apposite at this juncture to cite the relevant portions of these provisions, which form the basis of the cases of the parties.

[5] Section 20(1)(*b*) provides, in the relevant parts, as follows:

> "**20 Set-off of assessed losses—**(1) For the purpose of determining the taxable income derived by any person from carrying on any trade, there shall, subject to section 20A, be set off against the income so derived by such person—
>
> (*a*) any balance of assessed loss incurred by that person in any previous year which has been carried forward from the preceding year of assessment: … … …
>
> (*b*) any assessed loss incurred by a person during the same year of assessment in carrying on any other trade either alone or in partnership with others, otherwise than as a member of a company the capital whereof is divided into shares:
>
> **Provided that there shall not be set off against any amount—**
>
> **(*a*) … … …**
>
> **(*b*) derived by any person from a source within the Republic, any—**
>
> **(i) assessed loss incurred by such person during such year; or**
>
> **(ii) any balance of assessed loss incurred in any previous year of assessment,**
>
> **in carrying on any trade outside the Republic; or**
>
> (*c*) … … …
>
> (2) For the purposes of this section 'assessed loss' means any amount by which the deductions admissible under section 11 exceeded the income in respect of which they are so admissible."

(Emphasis added.)

[6] As regards, paragraph (*n*) of the definitions section 1 of the ITA, which was applicable at the relevant time, it provided for the specific inclusion in a taxpayer's "gross income" of:

> "(*n*) any amount which in terms of any provision of this Act is specifically required to be included in the taxpayer's income and that amount must—
>
> (i) for the purposes of this paragraph be deemed to have been received by or to have accrued to the taxpayer; and
>
> (ii) in the case of any amount required to be included in the taxpayer's income in terms of section 8(4), be deemed to have been received or accrued from a source within the Republic notwithstanding that such amounts may have been recovered or recouped outside the Republic."

[7] In disallowing the deduction of the accumulated assessed loss of R62 995 991, the Commissioner relied almost exclusively on the aforesaid paragraph (*n*)(ii) on the basis that the income earned by the taxpayer during 2018, in the form of a "recoupment", as explained later on in this judgment, is deemed to have been received or accrued "from a source within the Republic", which means that proviso (*b*)(ii) of section 20(1) of the ITA finds application. Therefore, so the argument on behalf of the Commissioner is concluded, the accumulated assessed loss cannot and should not be deducted from the 2018 income.

[8] The taxpayer disagrees, hence this appeal presently before us against the additional assessment pertaining to the 2018 tax year of assessment. The dispute between the taxpayer and the Commissioner is to be decided against the factual backdrop of the matter. The material and relevant facts, as set out in the paragraphs which follow, are common cause, same having been agreed upon as per *inter alia* a signed statement of agreed facts, which refers to and incorporates the material correspondence between the parties pertaining to the assessment. Importantly, as will be elaborated upon later on in the judgment, in the final pre-trial conference between the parties, the Commissioner accepted that the trade of the partnership, in which the taxpayer was a one third partner, had a "permanent establishment" in the UK, as defined in section 1 of the ITA, to which the aircraft was effectively connected. The significance of this undisputed permanent establishment is addressed later on in the judgment.

[9] Given the above agreements, it was not necessary for oral evidence to be led or for witnesses to be cross-examined and the parties closed their respective cases without leading evidence. Thereafter, the hearing of the matter proceeded directly to closing arguments based on the agreed common cause facts.

[10] To the extent that this appeal involves matters of law, this judgment and the order is my own. To the extent that issues of fact were considered and decided, the learned accountant member and commercial member concur with my findings.

[11] That brings me back to the facts in the matter.

[12] Up to and until 3 September 2017, the taxpayer was a "resident" of South Africa for tax purposes. Prior to that date, she and her father were members (holding one-third and two-third undivided shares respectively) of a partnership that owned and operated a passenger aircraft for charter purposes. The partnership, which traded under the name and style of "Tri-Air Aviation Partnership" was formed under and in terms of South African law. It ran a charter business using a passenger aircraft and charter business or trade operated in and from the UK. The aircraft was not registered to operate in South Africa, and did not do so. It was registered and based in the UK, where the business' offices were also situated.

[13] For South African income tax purposes, the partnership was governed by section 24H of the ITA. These provisions render a South African partnership "tax transparent", which, in effect, means that the partnership was thus not assessed as a taxpayer in its own right. The taxpayer, as a partner, earned her proportionate share of the partnership gross income and was also entitled to claim a proportionate share of the partnership deductions and allowances. She was taxable directly on her proportionate share of the taxable income.

[14] It is important to note that the taxpayer was not subject to income tax on the air charter business in the UK because, by virtue of Article 8(1) of the double tax treaty between South Africa and the UK, the profits of an enterprise of a Contracting State from operation of ships or aircraft in international traffic are taxable only in that State. Since the aircraft was an enterprise of the taxpayer and thus an enterprise of South Africa, and flew only inter-continentally, the UK had no taxing rights over the air charter trade. Only South Africa had the right to tax the profits, a right which was exercised since the inception of the partnership.

[15] The taxpayer had accordingly claimed, as deductions in prior years, a proportionate share of capital allowances, namely depreciation, permitted in relation to the aircraft under section 12C of the ITA. These deductions on an annual basis was in fact a claim annually of 20% on the cost of the aircraft. She had also deducted a proportionate share of other expenses of the air charter trade. The said deductions resulted in the partnership trade suffering losses for South African tax purposes in prior years. In other words, the deductions allowed exceeded the partnership's (gross) income, giving rise to "assessed losses" for the partnership.

[16] *Ordinarily*, a taxpayer may set off assessed tax losses against his or her other income in a year of assessment. The partnership losses were however not permitted to be set off against the taxpayer's other (non-partnership) South African income in the years preceding the 2018 year. Instead, they were carried forward as foreign assessed losses. This disallowance of the partnership losses was in accordance with proviso (b) to section 20(1) of the ITA referred to *supra*. The assessed losses in the partnership commenced from 1 March

2014 and continued until 28 February 2017. The partnership losses fell within the ambit of sub-paragraph (*b*)(ii) of the proviso in that they were incurred in carrying on the air charter trade outside South Africa.

[17] Because these losses could not be claimed against the taxpayer's South African income, at the end of her 2017 year of assessment (28 February 2017) she carried forward to the 2018 year a cumulative foreign assessed loss (arising out of the air charter trade) of R62 596 925.

[18] On 3 September 2017, the taxpayer moved permanently to the UK and ceased to be a "resident" for purposes of South African income tax. This gave rise to certain automatic tax consequences. One of these consequences was that, by operation of section 9H(2) of the ITA, the taxpayer was treated as having disposed of all of her assets (other than immovable property in South Africa and certain other assets not relevant here) to a person that is a resident of South Africa on the date immediately before the day on which she ceased to be a resident, that being on 2 September 2017, for an amount received or accrued equal to the market value of the asset on that date. The taxpayer was thus deemed *inter alia* to have disposed of her one-third share of the aircraft on 2 September 2017, at its market value.

[19] The deemed disposal, despite being of a capital nature, gave rise to a recoupment under section 8(4)(*a*) of the ITA, which reads (to the extent relevant) as follows:

> "There shall be included in the taxpayer's income all amounts allowed to be deducted or set off under the provisions of section 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 ...".

[20] *In casu*, it was agreed upon between the parties that the amount that was "recouped" arising from the deemed disposal of the taxpayer's one-third share of the aircraft was R67 995 951. This amount was included in the taxpayer's income for the 2018 year of assessment, which is the tax year that ended on the date prior to her emigration (2 September 2017). The taxpayer however claimed, as a deduction against what she alleges was her foreign income in that year, the amount of the carried-forward foreign assessed loss of R62 596 925. This, she did, on the basis that proviso (*b*) to section 20(1) did not disqualify the deduction. She reasoned that the assessed loss was not "ring-fenced" against the recoupment income. SARS however issued an additional assessment disallowing the set-off in its entirety on the basis that proviso (*b*) to section 20(1) precluded it. The taxpayer objected to and appealed to this court against the disallowance of the set-off.

[21] Therefore, the question to be considered by this court is whether the taxpayer is precluded by proviso (*b*) to section 20(1) from setting off her foreign assessed loss arising from the foreign air charter trade against the foreign trade income (recoupment) which arose from the deemed disposal of the aircraft in 2017.

[22] In considering this question, a convenient starting point is a brief discussion on the fact that at present and since 28 February 2001, liability for South African income tax is for the most part "residence" based, whereas prior to 28 February 2001 income tax liability was dependent upon the "source" of that income being South African. Prior to 28 February 2001, the place of residence of the taxpayer was not relevant to tax liability. Foreign residents would be liable for tax on income from a source within South Africa, while residents of South Africa would typically not be liable for tax on income that was from a foreign source.

[23] All this changed in 2001 when South Africa moved from a source-based to a residence-based system of income tax. From that date, South African residents became liable for South African tax on their world-wide income. There were exceptions to this general rule, based on international double tax treaties and other specific exemptions contained in section 10 of the ITA. After 2001, the source of income was only relevant in relation to non-residents. This was encapsulated in the ITA by way of an amendment to the definition of "gross income", which from 2001 distinguished between the basis of liability for residents and non-residents and defined "gross income" in the case of any resident, as "the total amount, in cash or otherwise, received by or accrued to or in favour of such resident". In the case of a non-resident, "gross income" was defined as "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".

[24] In the 2017 year of assessment, as in all prior years going back to the establishment of the air charter partnership, the taxpayer, as a resident of South Africa, was therefore liable for tax in South Africa in relation to her air charter business. This was despite the fact that the entire business was situated in and operated exclusively out of the UK, and had no operational link to South Africa at all.

[25] The fact that the taxpayer's air charter business was a foreign trade – located, and with a permanent establishment, in the UK – was however not irrelevant to her South African income tax treatment in the years up to September 2017. In terms of the general provisions of section 20(1) of the ITA, a taxpayer is entitled to set off against the income derived by him or her in a tax year any balance of assessed loss incurred by that person in any previous year carried forward from the preceding year of assessment. However, proviso (*b*) to section 20(1) prohibits the set-off of an assessed loss incurred in carrying on any trade outside the Republic against any amount "derived by any person from a source within the Republic". The effect of

proviso (*b*) is therefore to "ring-fence" foreign assessed losses, so that they cannot be set off against South African-sourced income.

[26] It was, however, submitted by Mr Janisch SC, who appeared on behalf of the taxpayer, that foreign assessed losses can be used to set off foreign-sourced income. And in support of that submission, he relies on *Explanatory Memorandum to the Taxation Laws Amendment Act 39 of 2013*, which reads as follows:

> "As a general matter, South Africa imposes income tax on residents on a world-wide basis. Theoretically, this world-wide basis of taxation also permits the deduction of expenses incurred in the production against both domestic and foreign income. However, in order to protect the domestic tax base against foreign erosion, the tax system ring-fences foreign losses. More specifically, the Income Tax Act forbids the deduction of foreign assessed losses or the balance of foreign assessed losses (i e net foreign trade losses) against income derived from carrying on a South African 'trade'."

[27] The significance of the 2013 Amendment Act, so Mr Janisch contends, was that proviso (*b*) had only prohibited the set-off of a foreign assessed loss against income derived from "the carrying on within the Republic of a trade". The legislature was concerned that this meant that South African income that was not derived from a "trade" – that is "passive income", such as interest – would not be so protected. For that reason, proviso (*b*) was amended to refer not to income derived from the carrying on of a trade in South Africa but derived "from a source within the Republic".

[28] There is merit in this contention, especially if regard is had to the further contents of the *2013 Explanatory Memorandum*, which reads thus:

> "At issue is whether a taxpayer can set off net foreign assessed losses from a foreign trade against South African passive income. It was always intended that these foreign losses should be fully ring-fenced to foreign income without offset against South African income. However, the current wording of the ring-fencing provision suggests otherwise. The current wording merely states that net foreign trade losses cannot be offset against domestic trading income. This language arguably means that net foreign trade losses (such as rental losses) may be set off against South African passive income (such as South African sourced salary)."

[29] It was because of proviso (b) that the taxpayer had built up an unused foreign assessed loss from the air charter trade. She had not been permitted to set off that "ring-fenced" assessed loss against her South African income. The 2018 year of assessment was however different. In that year she had foreign income in the form of the taxable recoupment which arose from the deemed (foreign) disposal of the aircraft on 2 September 2017.

[30] The question to be considered, as indicated earlier, is whether from that income the taxpayer is allowed to set off the foreign assessed loss. The taxpayer contends that the income in the form of recoupment – which related exclusively to, and arose exclusively from, the deemed disposal of the aircraft that was central to her foreign trade – was not derived from a source within the Republic. On the contrary, the recoupment was positively an amount received or accrued from a source outside the Republic in terms of section 9(4)(*d*) of the ITA.

[31] On the other hand, it is the case of the Commissioner that the amount represented by the recoupment was derived from a source within the Republic and he relies for this conclusion exclusively on the erstwhile sub-paragraph (*n*)(ii) of the definition of "gross income" in section 1 of the ITA, cited above. The Commissioner contends that, in the case of any amount required to be included in the taxpayer's income in terms of section 8(4), which is the provision in terms of which the recoupment arising from the deemed disposal of the aircraft was included in the taxpayer's income, was deemed (during 2017) to have been received or accrued from a source within the Republic notwithstanding that such amounts may have been recovered or recouped outside the Republic. This, so the contention goes, is in terms of the then paragraph (*n*)(ii) of the definitions section of the ITA, if regard is had to the express wording of the said paragraph, no recoupment arising from section 8(4) could ever be categorised as foreign income under our tax law.

[32] The very crisp point made by the Commissioner is that the recoupment amount was included in the "gross income" of the taxpayer in terms of section 8(4)(*a*) of the ITA, which means that paragraph (*n*)(ii) was implicated. Therefore, so the argument goes, such income was deemed to have been received or accrued from a source within the Republic. This, in turn, means that, against such income, the foreign assessed loss cannot be set off.

[33] At first blush, there appears to be merit in the Commissioner's contention. After all, that is what the wording of the applicable provision says. The point is simply that a section 8(4)(*a*) recoupment included in a taxpayer's income is "income received or accrued from a source within the Republic" by virtue of paragraph (*n*)(ii), therefore proviso (*b*)(ii) kicks in.

[34] The taxpayer disagrees. She contends that sub-paragraph (*n*)(ii) has no bearing on or application to the taxpayer. It applies, so the submission by the taxpayer goes, at most to the characterisation of gross income of a non-resident (which the taxpayer was not at the relevant time), whose tax liability is still dependent on source.

[35] In the alternative, the taxpayer contends that, even if sub-paragraph (*n*)(ii) is in principle applicable to her, it is of no force and effect in that section 9(4)(*d*), read with section 9(2)(*k*), of the ITA expressly provides that the recoupment amount in question is to be regarded as having been received by or accrued to the taxpayer from a source outside the

Republic. This positive and peremptory characterisation of the amount as from a source outside the Republic, so the taxpayer contends, prevails over any application of the obsolete sub-paragraph (n)(ii), and therefore proviso (*b*) to section 20(1) does not apply to the recoupment income.

[36] The taxpayer contends that, on a correct and proper interpretation of the applicable provisions of the ITA, she should prevail in this appeal.

[37] It is so, as submitted by Mr Janisch, that the modern approach towards the interpretation of statutes, as formulated by Wallis JA in the oft-quoted case of *Natal Joint Municipal Fund v Endumeni Municipality*,[3] emphasises the unitary nature of the interpretative exercise. While the language used in the legislation is the inevitable starting-point, it must be read within its context, having regard to "the matter of the statute, its apparent scope and purpose, and within limits, its background". See *Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs and Tourism*.[4]

[38] Also, so Mr Janisch submitted. The so-called *contra fiscum* rule of interpretation remains part of our law, and is accommodated within the unitary *Endumeni* approach. I agree. That much was held by *Telkom SA SOC Limited v Commissioner: SARS*,[5] in which Swain JA referred, with approval, to the following passage from *NST Ferrochrome (Pty) Ltd v Commissioner for Inland Revenue*:[6]

> "... Where there is doubt as to the meaning of a statutory provision which imposes a burden, it is well established that the doubt is to be resolved by construing the provision in a way which is more favourable to the subject, provided of course the provision is reasonably capable of that construction … … But, where any uncertainty in a statutory provision can be resolved by an examination of the language used in its context, there is no rule of interpretation which requires that effect be given to a construction which is found not to be the correct one merely because that construction would be less onerous on the subject."

[39] In applying the aforegoing principles, it is appropriate to have regard to the legislative history of the provisions in question. Paragraph (*n*) is an extension of the definition of "gross income", as is apparent from the words which precede it, that being "but including, without in any way limiting the scope of this definition".

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[3] *Natal Joint Municipal Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA).

[4] See *Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs and Tourism* 2004 (4) SA 490 (CC) at para 89.

[5] *Telkom SA SOC Limited v Commissioner, SARS* 2020 (4) SA 480 (SCA).

[6] *NST Ferrochrome (Pty) Ltd v Commissioner for Inland Revenue* 2000 (3) SA 1040 (SCA) at para 17.

[40] Paragraph (*n*) was enacted during the time of the source-based regime. The provision served two purposes in the context of the "gross income" definition. Firstly, it had the effect that amounts which elsewhere in the ITA were stated to form part of a taxpayer's "income" also formed part of that taxpayer's "gross income". Secondly, as acknowledged in the Explanatory Memorandum to the Bill which ultimately repealed sub-paragraph (*n*)(ii) in 2019, it "was designed to prevent taxpayers from exporting depreciable assets and then arguing that the proceeds on disposal were from a source outside the Republic, and hence not subject to recoupment". Thus it ensured that a taxpayer who had employed an asset in a South African business (giving rise to SA-sourced income), and had benefited from the deduction of allowances on that asset, could not simply export the asset before disposing of it, and then argue that any recoupment arose from an originating cause (the disposal of the asset) that was located outside South Africa.

[41] Sub-paragraph (*n*)(ii)) was, in my view, an anti-avoidance provision aimed at supporting the source-based tax regime for "gross income". It was necessary because the mere fact that the taxpayer was a resident would not suffice to include the recoupment in "gross income" if the asset was disposed of in a foreign jurisdiction. This paragraph would under the pre-2001 "source" regime have had no impact on residents who conducted a foreign trade offshore, as they would not have claimed deductions or allowances for purposes of South African tax and so would also not have had taxable recoupments.

[42] Section 9 was introduced during the residence-based tax regime – which is not the case with paragraph (*n*)(ii) – and was made "applicable in respect of amounts received or accrued during years of assessment commencing on or after [1 January 2012]". Section 9(2) provides that an amount is received by or accrues to a person from a source within the Republic in a number of defined circumstances. Section 9(4) goes on to provide that an amount is received by or accrues to a person from a source outside the Republic in a further number of defined circumstances as per sub-paragraphs (*a*) to (*e*).

[43] As submitted by Mr Janisch, the new section 9 was significant in that it was made necessary by a "paradigm shift" in the legislation (i e the move from source to residence) and it was intended to restate a new "uniform set of source rules" to remedy uncertainties and anomalies. Additionally, it eliminated the concept of "deemed source" that had previously existed. The "deemed source" language of sub-paragraph (*n*)(ii) however remained on the statute book until 2019, when the provision was repealed in its entirety. It is apparent from the associated *Explanatory Memorandum* that this was because the provision was obsolete and served no useful purpose.

[44] For all of these reasons, I am in agreement with the submissions made on behalf of the taxpayer relative to the issue as to whether paragraph (*n*)(ii) applies to the taxpayer. The Commissioner's argument that the said paragraph deems the recoupment to be from a source in South Africa, is a literal and isolated interpretation, disregarding context. Since the introduction of the residence-based regime with effect from 2001, the "gross income" definition deals separately with the basis of tax liability for residents and non-residents.

[45] In relation to residents, the source of any non-capital amounts received or accrued is irrelevant. Such income forms part of their gross income by virtue of sub-paragraph (i), whatever its source. And it is only in respect of non-residents who receive or accrue non-capital amounts that the additional requirement of a South African source applies under sub-paragraph (ii). As correctly submitted by Mr Janisch, the sole operative effect of the now repealed sub-paragraph (*n*)(ii) was to deem an amount to be from a South African source for purposes of the gross income definition, where the provision is located. Its scope of operation was thus naturally limited to income that fell within "gross income" by virtue of its source – namely the income of non-residents only. The provision served no useful purpose, in the context of the "gross income" definition, in relation to residents: the recoupment income automatically accrued to them as gross income by virtue of their status as residents.

[46] Accordingly, I am of the view that sub-paragraph (*n*)(ii) is of no application to the taxpayer's recoupment. Moreover, in my view, the deeming of source is not intended to apply outside the realm of the "gross income" definition. In context, sub-paragraph (*n*)(ii) applies, like sub-paragraph (*n*)(i), for the purpose only of paragraph (*n*) – the whole aim of which is to include amounts in gross income. It does not apply for all purposes of the ITA, such as section 8(4). This is reinforced by the use of the words "for the purposes of this paragraph", which were part of the original wording of paragraph (*n*).

[47] This then, in my view, spells the end of the case for the Commissioner and the appeal should be upheld.

[48] Even if I am wrong on this aspect and the interpretation of the relevant provisions, the appeal must nevertheless succeed for the reasons which follow.

[49] It is contended by the taxpayer that paragraph (*n*)(ii) if the definitions section is, in any event, of no force and effect in the light of other provisions of the ITA, notably section 9(4)(*d*), in terms of which the income in these circumstances is from a source outside the Republic.

[50] Section 9(4)(*d*) provides as follows:

> "An amount is received by or accrues to a person from a source outside the Republic if that amount –
>
> (*a*) … …
>
> (*d*) constitutes an amount received or accrued to that person in respect of the disposal of an asset that is not from a source within the Republic in terms of subsection (2)(*j*) or (*k*)."

[51] As rightly submitted by the taxpayer, the recoupment in the circumstances of this matter is plainly an amount received or accrued to the taxpayer "in respect of the disposal" of the aircraft. The words "in respect of" connote a causal connection (*De Villiers v Commissioner of Inland Revenue*;[7] *Stander v Commissioner for Inland Revenue*[8]). The recoupment only arises because of the deemed disposal of the aircraft, and is directly linked to it. Thus there is a direct causal connection between the disposal and the amount of the recoupment in issue.

[52] The further question is whether the amount is regarded as being from a source within the Republic under either section 9(2)(*j*) or section 9(2)(*k*). If either of those provisions applies, the recoupment will be from a South African source under section 9(2). If not, it is from a foreign source.

[53] The provisions read as follows:

> "(2) An amount is received by or accrues to a person from a source within the Republic if that amount—
>
> (*a*) ... …
>
> (*j*) constitutes an amount received or accrued in respect of the disposal of an asset that constitutes immovable property held by that person or any interest or right of whatever nature of that person to or in immovable property contemplated in paragraph 2 of the Eighth Schedule and that property is situated in the Republic;
>
> (*k*) constitutes an amount received or accrued in respect of the disposal of an asset other than an asset contemplated in paragraph (j) if—
>
> (i) that person is a resident and—
>
> (*aa*) that asset is not effectively connected with a permanent establishment of that person which is situated outside the Republic; and

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7 *De Villiers v Commissioner of Inland Revenue* 1929 AD 227 at 229.

8 *Stander v Commissioner for Inland Revenue* 1997 (3) SA 617 (C) at 622I-J.

(*bb*) the proceeds from the disposal of that asset are not subject to any taxes on income payable to any sphere of government of any country other than the Republic; or

(ii) that person is not a resident and that asset is effectively connected with a permanent establishment of that person which is situated in the Republic;"

[54] Section 9(2)(*j*) cannot possibly apply in this matter as the aircraft which was disposed of is not immovable property. All other types of assets (apart from immovable property), including the aircraft, fall within the ambit of section 9(2)(*k*). The question is whether its further requirements apply to make this South African-sourced income.

[55] In that regard, only sub-paragraph (*k*)(i) is relevant, as the taxpayer was, at the time of the deemed disposal, a resident of South Africa, in which case two requirements must both be fulfilled ("and") for the proceeds to be regarded as being from a South African source. The first requirement is in sub-paragraph (i)(*aa*). It applies where the asset disposed of is not effectively connected with a permanent establishment of the taxpayer situated outside South Africa. It is common cause between the parties *in casu* that the air charter trade had a "permanent establishment" in the UK, to which the aircraft was effectively connected. This is also factually the case. That is the end of the latter enquiry: the proceeds cannot then be from a source in South Africa under section 9(2).

[56] Since the recoupment proceeds accrued in respect of the disposal of an asset that is not from a source within the Republic in terms of sub-section (2)(*j*) or (*k*), section 9(4)(*d*) positively identifies the amount as having been received or accrued "from a source outside the Republic". For that reason, proviso (*b*) to section 20(1) of the ITA does not apply to disqualify the set-off of assessed loss against the recoupment income.

[57] This then means that, if regard is had to section 9(4)(*d*), the taxpayer should have been allowed the deduction. Conversely, on the basis of paragraph (*n*)(ii), the deduction was rightly disallowed by the Commissioner. The question is whether section 9(4)(*d*) prevails over paragraph (*n*)(ii) or *vice versa*. How then is this irreconcilable inconsistency between the two provisions to be resolved.

[58] Paragraph (*n*)(ii) was the earlier provision. Section 9(4)(*d*) was introduced many years later, and expressly applies to all receipts and accruals of a taxpayer from 2012 onwards. As submitted on behalf of the taxpayer, the general rule of statutory interpretation in this context, as per *Khumalo v Director-General of Development and Co-operation*,[9] is as follows:

> "It is, of course, true that in general an earlier enactment is to be regarded as impliedly repealed by a later one if there is an irreconcilable conflict between the provisions of the two enactments."

[59] On the basis of that general rule, the provisions of section 9(4)(*d*) should, in my view, prevail. Moreover, section 9(2) is a single provision which regulates when an amount is received by or accrues to a person from a source within the Republic. Section 9(2) is juxtaposed against section 9(4), which regulates when an amount is received or accrues from a source outside the Republic. The aim was clearly to draw together the statutory regulation of local and foreign source.

[60] What is more is that section 9 was expressly stated to be applicable to "amounts received or accrued during years of assessment ending on or after [1 January 2012]". Thus it was intended to regulate all such amounts received or accrued, without exception. In the circumstances, there is no scope for an argument that there are some receipts or accruals of the same type whose source it does not regulate (which would be the case if paragraph (*n*)(ii) applied).

[61] Also, there are clear indications that the new section 9 provisions relating to source rendered paragraph (*n*)(ii) obsolete and ineffectual. Firstly, paragraph (*n*)(ii) is, at best, a "deemed source" provision in that it does not regulate where the actual source of the income is, but provides for a fiction in this regard. The introduction of section 9 however spelled the end of the system of "deemed source" in the ITA. From that point onwards, the ITA (through section 9) provided positively for when an amount "is received by or accrues to a person" from a source either inside the Republic (section 9(2)) or outside the Republic (section 9(4)).

[62] Secondly, shortly after the introduction of section 9, sub-paragraph (ii) of paragraph (*n*) of the "gross income" definition was amended to remove any reference to "deemed source", leaving only "source" as the touchstone, with section 9 telling one when an amount was from a South African source. The way section 9 dovetails linguistically with the amended sub-paragraph (ii) is another indication that demonstrates that the new (actual) source provisions were intended to form a united whole in the ITA. By the same token, paragraph (*n*)(ii), which referred to "deemed source", was set loose from its statutory anchor and became superfluous.

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9 *Khumalo v Director-General of Development and Co-operation* 1991 (1) SA 158 (A) at 164C.

[63] I accordingly find myself in agreement with the submission made by Mr Janisch that the provisions of paragraph (*n*)(ii) were merely remnants of a bygone era, superseded by a new manner of regulating the actual source of income and allowed to remain in the ITA by way of a legislative oversight. The introduction of the comprehensive new source regime (not "deemed source") rendered them superfluous, as the legislature ultimately recognised.

[64] There is another reason why the relevant provisions of the ITA should be interpreted so as to support the case of the taxpayer and that relates to the rule of interpretation that, in the proper interpretation of the ITA, regard should be had to the impact of the two competing approaches, and to ask whether they give rise to sensible and business-like results, as opposed to insensible or even absurd consequences that could not have been intended.

[65] The taxpayer contended that the Commissioner's approach does indeed lead to insensible and unbusinesslike results, while the same cannot be said of her approach. Firstly, so the submission goes, proviso (*b*) to section 20(1) clearly aims to protect the taxability of the income, namely the South African tax base, of a resident from local sources against losses arising from a foreign trade. The proviso does not prohibit setting off the foreign assessed loss against the resident taxpayer's foreign-sourced income, neither does it prevent setting off local source losses against foreign income. I agree with this submission. The point is that the income which falls into the taxpayer's hands as a result of the recoupment on the aircraft disposal has nothing to do with South Africa, other than its connection to the taxpayer. It would not have arisen had there been no foreign trade. The SARS approach therefore does not protect the taxability of income that actually arose in South Africa, as proviso (*b*) is meant to do. It consequently does not achieve the statutory purpose.

[66] Secondly, the SARS approach has the effect that income that is, as a fact, related directly and exclusively to a foreign trade cannot be reduced by assessed losses built up through conducting that self-same foreign trade. This creates an imbalance and lack of symmetry in the taxation of the foreign trade. It also results in the permanent sterilization of that assessed loss where no further foreign trade is conducted (which will often be the case where a recoupment arises as a result of the disposal of a foreign asset).

[67] Thirdly, the circumstances for which paragraph (*n*)(ii) was originally introduced, that being to subject a recoupment to tax where the asset was operated as part of a trade in South Africa and then exported, are not present on the current facts. On the contrary, the asset was always part of a foreign trade, and the foreign recoupment proceeds will (by virtue of residence) be reflected in the taxpayer's South African tax calculation. Paragraph (*n*)(ii) was enacted to counter a mismatch between the claiming of deductions under a local trade and the non-taxability of an associated foreign recoupment. No such mismatch exists here.

Disallowing a set-off of the foreign assessed loss in these circumstances achieves no legitimate or sensible tax purpose.

[68] Fourthly, the anomalous consequences of the SARS approach are demonstrated by the reality that, by not allowing the set-off of a foreign assessed loss against the recoupment of a foreign trade asset, the resident taxpayer will end up paying income tax over the full period on an amount exceeding his or her accounting profit from that trade. This runs counter to commercial common sense. And lastly, the SARS approach gives rise to the bizarre result that on the basis of proviso (*b*) to section 20(1) a resident taxpayer who invests in an asset to conduct a foreign trade cannot obtain a deduction of capital allowances against any of his or her South African income, and yet on disposal of the asset is taxed on recoupments of amounts in respect of which no deduction was in practice allowed. The rationale for taxing recoupments is that the taxpayer cannot be allowed to retain the tax benefit of past deductions granted where the amounts so deducted have been recovered. But here, he or she would be taxed on the recoupment of amounts which were not allowed as deductions to begin with. This is plainly anomalous.

[69] For these reasons, I am of the view that unbusinesslike consequences result from elevating paragraph (*n*)(ii) above its original purpose as a limited anti-avoidance measure under the source basis of taxation. Accordingly, the approach of the taxpayer to the interpretation of the applicable ITA provisions is to be adopted, in which case there will be a proper symmetry between the foreign income from disposal of the aircraft and the deduction of foreign losses arising from the same trade, and no unmatched income or unusable assessed losses. No anomalous, insensible or unbusinesslike consequences will arise.

[70] In sum, I conclude that, on a proper interpretation, paragraph (*n*)(ii) does not apply in the operation of proviso (*b*) to section 20(1). But even if paragraph (n)(ii) is of potential application to the present facts, it cannot prevail over the more recent and comprehensive provisions of section 9(4)(*d*), read with section 9(2)(*k*) which peremptorily treat the income from the sale of the aircraft as arising from a foreign source. To regard that income as from a South African source in the face of these provisions is, as submitted on behalf of the taxpayer, absurd.

[71] As regards the interest payable in terms of section 89*quat*(3) of the ITA, it is so, as submitted by Mr Janisch, that this interest follows if the assessment is upheld, and falls away if not. It does not stand and fall on independent grounds. Therefore, *in casu*, in view of the fact that the additional assessment falls to be set aside, the interest should suffer the same fate.

Conclusion and Costs

[72] The appeal therefore stands to be upheld and the additional assessment pertaining to the 2018 tax year should be set aside.

[73] As for costs, same is ordinarily not awarded in favour of any of the parties in the tax court, unless a party shows that the other party's grounds of assessment or appeal are unreasonable. In this matter, neither party has claimed costs. In any event, it cannot be said that SARS, in imposing the additional assessment for the 2018 tax year, acted unreasonably or that their grounds for the additional assessment were unreasonable. I need therefore not address this issue further.

[74] Each party should therefore bear his own costs.

Order

[75] Accordingly, I make the following order:

(1) The appellant's appeal against the additional assessment for the 2018 year of assessment is upheld.

(2) The said additional assessment be and is hereby set aside.

(3) The respondent be and is hereby directed to issue a new assessment which permits the set-off of the foreign assessed loss against the appellant's foreign source recoupment income.

(4) There shall be no order as to costs.

L R ADAMS
President of the Tax Court
Johannesburg

ACCOUNTANT MEMBER: Ms M Dikotla
COMMERCIAL MEMBER: Ms G Gould
FOR THE APPELLANT: Advocate M W Janisch SC
INSTRUCTED BY: Werksmans Attorneys, Sandton
FOR THE RESPONDENT: Mr M D L Jorge
INSTRUCTED BY: South African Revenue Services, Pretoria
HEARD ON: 13 February 2023
JUDGMENT DATE: 21 February 2023