

TRANSVAAL TAX COURT
HELD AT JOHANNESBURG

BEFORE

The Honourable Mr Justice M M Joffe

President

“A”

Appellant

and

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

Respondent

In the appeal of: A

CASE NO 10919

(Heard at Johannesburg on 15 November 2002)

JUDGMENT

JOHANNESBURG

JOFFE, J:

[1] The appellant submitted an income tax return for the year of assessment ended 28 February 1992. He claimed the sum of R700 000,00 as a deduction from his taxable income. The claim was based on section 25B(3) of the Income Tax Act, 58 of 1962 as amended (“the Act”). The deduction was not allowed hence the present appeal. The appellant further contends that the Commissioner should have directed that interest which was levied in terms of section 89(quat) of the Act ought not to have been levied pursuant to the discretion vested in the Commissioner in terms of section 89(quat) (3) of the Act.

[2] At the commencement of the appeal a written document embodying an agreement between the parties was handed in (exhibit A). It sets out the issues that arise in the appeal as follows:

“1 The parties are in agreement that the issues are the following:

- 1.1 In broad terms the issue is whether the facts in the current instance fall within the ambit of section 25B of the Income Tax Act, No 58 of 1962.
- 1.2 More specifically, whether the Appellant has acquired any vested right to income in consequence of the exercise by the trustee of a discretion vested in him in terms of the trust deed, as required by section 25B(1) and (2), in order for the provisions of section 25B(3) to come into operation.
- 1.3 The Respondent is not relying on the reason of disallowance that the loss is of capital nature (p128 of the Dossier).
- 1.4 The assessment in question is not an estimated assessment as stated in the letter contained on p139 of the dossier.
- 1.5 Whether appellant is entitled to have the interest levied in terms of s 89 quat remitted.

2. The Respondent agrees that the Appellant may advance any argument he deems fit, which falls within the ambit of the above issues.”

[3] The appellant was the only witness called at the hearing of the appeal. It emerged from his evidence that he was the donor as well as one of the trustees and beneficiaries of The I Trust (“the Trust”). His wife and children comprise the other trustees.

[4] He testified that during the course of the financial year ended 29 February 1992 it became apparent that the Trust had incurred trading losses. Advice was obtained from the Trust’s accountants. Pursuant thereto a meeting of the trustees of the Trust was held. The meeting was held on 29 November 1991. The trustees present at the meeting resolved as follows:

“In view of the expected losses which the Trust is anticipated to incur for the year ended 28 February 1991 the Trustees resolved that 70% of the net loss would be distributed to Mr (B), a beneficiary, in his personal capacity.

This decision was made in terms of Section 25(B) of the Income Tax Act, whereby provision is made where expenditure exceeds income the net loss can effectively be transferred in a beneficiary and set off against other income derived by the beneficiary.

This decision was made in consultation with the Trust auditors Messrs Ernst & Young.”

[5] The loss that was anticipated in November 1991 was realised. The Trust incurred a loss of R998 845,00. According to the Trust's financial statements for the year ended 31 March 1992, R700 000,00 of the loss was distributed to the appellant leaving the Trust with a loss of R298 845,00.

[6] The R700 000,00 loss that was distributed to the appellant is reflected in the Trust's financial statements for the year ended 31 March 1992 as "Trustees' loan". In the appellant's schedule of assets and liabilities as at 28 February 1992 the R700 000,00 is reflected as a liability namely "Loan – I Trust". The appellant testified that he repaid the Trust the amount of R700 000,00 over a period of time. This is not consistent with a distribution as is contemplated by section 25B of the Act. It is consistent with the recapitalisation of the Trust. The distribution only has potential tax implications for the appellant. This was however not fully canvassed in cross-examination with the appellant. It would in the circumstances not be safe to base a judgment thereon.

[7] Section 25B of the Act read as follows during the 1992 year of assessment:

“Income of trusts and beneficiaries of trusts. – (1) Any income received by or accrued to or in favour of any person in his capacity as the trustee of a trust referred to in the definition of 'person' in section 1, shall, subject to the provisions of section 7, to the extent to which such income has been derived for the immediate or future benefit of any ascertained beneficiary with a vested right to such income, be deemed to be income which has accrued to such beneficiary, and to the extent to which such income is not so derived, be deemed to be income which has accrued to such trust.

(2) Where a beneficiary has acquired a vested right to any income referred to in subsection (1) in consequence of the exercise by Trustee of a discretion vested in him in terms of the relevant deed of trust, agreement or will of a deceased person, such income shall for the purposes of that subsection be deemed to have been derived for the benefit of such beneficiary.

(3) Any deduction or allowance which may be made under the provisions of this Act in the determination of the taxable income derived by way of any income referred to in subsection (1), shall, to the extent to which such income is under the provisions of that subsection deemed to be income which has accrued to a beneficiary or to the trust, be deemed to be a deduction or allowance which may be made in the determination of the taxable income derived by such beneficiary or trust, as the case may be.”
(emphasis provided).

[8] According to Silke on South African Income Tax, para 12.14A, section 25B operates as follows:

“The income s 25B affects is the income received by or accrued to or in favour of a person during any year of assessment in his capacity as the trustee of such a trust. The ‘deemed income’ rule establishes that:

- *To the extent to which such income has been derived for the immediate or future benefit of an ascertained beneficiary who has a vested right to it during such year, it will be deemed to be income that ha accrued to the beneficiary.*

- *And, to the extent to which it is not derived for the immediate or future benefit of an ascertained beneficiary with a vested right to it, it will be deemed to be income that has accrued to the trust itself.*

- *The discretionary-income rule governing the situation comes into operation when the trustee exercises a discretion vested in him in terms of the trust deed and, as a result, a beneficiary acquires a vested right to income received by or accrued to or in favour of the trustee in his capacity as such. For the purposes of the deemed income-rule governing the taxation of income of trusts, that income will be deemed to have been derived for the benefit of the beneficiaries concerned.”*

[9] As is apparent from the minutes of the trustees’ meeting of 29 November 1991 there is no evidence of an exercise of discretion by the trustees to distribute income to the appellant. All that is recorded is a resolution to distribute 70% of the nett loss of the Trust.

[10] Section 25B(2) requires that the right to income must vest “in consequence of the exercise by the trustee of a discretion vested in him in terms of the relevant trust deed”. The subsection therefore requires an investigation of the trust deed to determine whether the trustees exercised their discretion in terms of the provisions of the trust deed.

[11] Clause 10 of the trust deed provides as follows:

“10. **BENEFICIARIES**

10.1 The Trustees shall have the power, in their sole discretion to do any one or more of the following:

10.1.1 to pay the whole or any part of the income of the Trust Fund to any one or more of the children, grandchildren and remoter descendents (or spouse of any such person) of the Donor and/or the Donor

10.1.2 to use the whole or any part of the income of the Trust for the maintenance and well being or any one or more of the beneficiaries in 10.1.1

10.1.3 to pay any such income into the account with any bank or building society and to operate such account for the benefit of any such beneficiary.”

[12] The word “*income*” is not defined in the trust deed. The use of the words “*to pay*” (para 10.1.1) and “*to use*” (para 10.1.2) the whole or any part of the income is indicative that the trustees were only empowered to make a positive distribution to the beneficiaries. It does not provide for a distribution of a nett loss.

[13] Appellant's counsel referred to clauses 17.8 and 18.20 of the trust deed as the source of the authority for the trustees to distribute the aforementioned loss. Neither of these clauses authorise the trustees as submitted.

[14] In the premises as the appellant has not brought himself within the ambit of section 25B of the Act the appeal falls to be dismissed in regard to that issue.

[15] Section 89 (quat)(3) of the Act reads as follows:

"Where the Commissioner having regard to the circumstances of the case is satisfied that any amount has been included in the taxpayer's taxable income or that any deduction, allowance, disregarding or exclusion claimed by the taxpayer has not been allowed, and the taxpayer has on reasonable grounds contended that such amount should not have been so included or that such deduction or allowance should have been allowed, the Commissioner may direct that interest shall not be paid by the taxpayer on so much of the said normal tax as is attributable to the inclusion of such amount or the disallowance of such deduction or allowance." (emphasis provided).

[16] The Commissioner's discretion in this regard is made subject to objection and appeal and the onus is on the appellant to place sufficient grounds before the court to justify interference with the Commissioner's decision. See ITC 1601 58 SATC 172 at 180.

[17] As appears from the foregoing it is clear that no Trust income accrued to the appellant and in the circumstances the appellant could not have reasonably

believed that the Trust expenditure would have been deemed to be incurred by him. This is not a question of the wrong interpretation of a section of the Act but an instance where the necessary facts to rely on the section never occurred. In the circumstances appellant could not have reasonably believed that he was entitled to the deduction. In the result the appeal in this regard falls to be dismissed as well.

[18] In the result the following order is made:

The appeal is dismissed.

SIGNED

M M JOFFE – PRESIDENT

SIGNED

T TSHIKOVHI – ASSESSOR

SIGNED

G M NEGOTA – ASSESSOR

The judgment should be reported	X YES	NO
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