IN THE INCOME TAX SPECIAL COURT

BEFORE

The Honourable Mr Justice L I Goldblatt	President
I B Skosana	Accountant Member
M C van Blerck	Commercial Member

In the appeal of:

CASE NOS 11553, 11554 and 11555

(Heard at Johannesburg 11th March 2005)

JUDGMENT
7 April 2005

JOHANNESBURG

GOLDBLATT J:

1. The appellants are developers of retirement villages and have conducted the business of development and marketing of retirement villages since 1988, as contemplated in the Housing Development Schemes for Retired Persons Act, No 65 of 1988.

2. During the period in issue in this matter the appellants disposed of the right to

occupy units in retirement villages in exchange for the receipt of an "interest free loan". These rights of occupation were known as "life rights".

3. The life rights were disposed of to retired persons in terms of a standard "Life Rights Agreement" ('Lewensreg Ooreenkoms') containing the following clauses:

3.1 Definition of *'lening':*

" *'n Rentevrye lening deur die Okkupeerder aan die Maatskappy in die bedrag van Rx"*

3.2 Definition of *'Lewensreg':*

'Die reg van die Okkupeerder om die Eenheid te okkupeer en die Fasiliteite te gebruik, onderworpe aan die Reëls vanaf Datum van Okkupasie tot Datum van Beëindiging as teenprestasie vir die Lening en onderworpe aan die betaling van Maandelikse Heffings en Spesiale heffings. '

3.3 Clause 6.4:

'As teenprestasie vir die Lening onderneem die Maatskappy om aan die Okkupeerder Lewensreg van die Eenheid te verleen...'

3.4 Clause 8:

"8. 1 *Die grondslag van hiedie ooreenkoms is Lewensreg teen 'n Lening met Sekuriteit.* . .

8.2 *Die Okkupeerder sal geregtig wees* om *sy Lewensreg op te sê en hierdie ooreenkoms te kanselleer nadat minstens* 3 *(Drie) MAANDE vooraf skriftelike kennisgewing per aangetekende pos tot daardie effek*

deur die Okkupeerder aan die Maatstkappy en aan die Bestuur gegee is.

8.3 *Die Lewensreg van die Okkupeerder word outomaties beëindig by die oorlye van die Okkupeerder* of *die langslewende indien daar twee Okkupeerders ten opsigte van dieselfde Eenheid is, nagelang van die geval, sowel* as *by kansellasie van hierdie ooreenkoms* as *gevolg van versuim deur die Okkupeerder.*

8.4 *.....Terugbetaling van die Lening sal in alle gevalle onderworpe wees aan die voorwaardes volgens klousule6.6 hierbo, behalwe waar dit te wyte is aan enige versuim deur die Maatskappy."*

4. The Commissioner initially assessed the appellants on the net amount of loans received during a year of assessment. The appellants objected to these assessments and the Commissioner has withdrawn such assessments and has issued "revised" assessments on the basis that the benefit received by the appellant, ie the right of use of the interest free loan, constitutes a reward in a form other than cash which is taxable in terms of the definition of "gross income". The Commissioner has determined the value of the accrual of this alleged benefit by applying the average market related interest rate to the average amount of the loans in the possession of the appellant in a particular year.

5. The appellants have objected to the aforesaid assessments on the ground, inter alia, that they have not received the aforesaid receipt and that accordingly the amount assessed by the Commissioner as being part of - their "gross income" is not Income.

6. Thus the issue to be decided by us is whether or not the appellants received the alleged "benefit" and if so whether such "benefit" falls within the definition of "gross income" as contained in section 1 of the Income Tax Act, No 58 of 1962 ("the Act").

7. "Gross income" is defined in section 1 of the Act:

"gross income" in relation to any year or *period* of *assessment means*

(i) *in the case* of *any resident, the total amount, in cash* or *otherwise, received by* or *accrued to* or *in favour* of *such resident;* or

(ii) .....

during such year or period of assessment, excluding receipts or accruals of a capital nature, but including without in any way limiting the scope of this definition, such amounts (whether of a capital nature or not) so received or accrued as are described hereunder, namely.. "

8. In Lategan v CIR 1926 CPD 203 (2 SATC 16) Watermeyer J (as he then was) said the following at 207:

> *"The definition seemed also to contemplate that 'gross income' should, except in the case of income from employment, always be a sum of money, because it used the words 'total amount', and 'amount' usually meant an amount of money. But the word 'income' in its ordinary sense did not always consist of money, as had been pointed out in Booysen's case (1918, AD 576) . 'Income', unless it was in some form such as a pension or annuity, was what a man earned by his work or his wits or*

by employment of *his capital. The rewards which he got might come to him in the form* of *cash or* of *some other kind* of *corporeal property or in the form* of *rights. Ordinarily speaking the value of those rewards was the man's income. Unless the 'amount' meant something more than an amount of money the definition given in the Act would not seem to be wide enough to include of property or rights earned by the taxpayer unless they were benefits in respect of employment. The Legislature could hardly, however, have intended such a result because then it would be open to any taxpayer (who did not earn his income by employment) to receive payment in some form other than money and thus escape taxation. In his Lordship's opinion the word 'amount' had to be given a wider meaning and must include not only money but the value of every form of property earned by the taxpayer whether corporeal or incorporeal which has a money value."*

9. In **CIR v People's Stores (Walvis Bay) (Pty) Ltd** 1990 (2) SA 353 (A) (25 SA TC 9) Hefer JA quoted the above passage from Lategan's case and continued as follows at 363:

"The first and basic proposition is that income, although expressed as an amount in the definition, need not be an actual amount of money but may be 'every form of property earned by the taxpayer, whether corporeal or incorporeal, which has a money value.. including debts and rights of action' (per Watermeyer J at 209).

This proposition is obviously correct so that very little need to be added to what Watermeyer J himself said in support thereof. It is hardly conceivable that the Legislature could not have been aware of, or would have turned a blind eye to, the handsome profits often reaped from commercial transactions in which money is not the medium of exchange. Consider, for example, the many instances of valuable property changing hands, not for money, but for shares in public or private companies; or share cropping agreements,

dividends in the form of bonus shares, or remuneration for services in the form of free and or subsidised housing and the use of motor vehicles. These are only a few of the many possible illustrations that readily come to mind and which, as we know, have not been overlooked by the Legislature. Nor can the reference in the definition of 'gross income' in the 1962 Act to receipts and accruals 'in cash or otherwise', or other provisions of the Act (such as paras (h) and (i) of the definition, s 26(1) read with the First Schedule and s 11 (i) and (j) be ignored. There are clear indications in all these provisions of the extended meaning of 'amount'.

The learned judge continued as follows at 364:

"It must be emphasised that income in a form other than money must, in order to qualify for inclusion in 'gross income', be of such a nature that a value can be attached to it in money. As Wessels CJ said in the Delfos case supra at 251:
'The tax is to be assessed in money on all receipts or accruals having a money value. If it is something which is not money's worth or cannot be turned into money, it is not regarded as income. '
(See also Mooi v Secretary for Inland Revenue (supra at 683A-F). On the other hand, the fact that the valuation may sometimes be a matter of considerable complexity (cf the Lace Property Mines case supra at 279 - 81) does not detract from the principle that all income having a money value must be included. How the valuation is to be done depends, of course, entirely on the nature of the income and the circumstances of the case. ' "

10. The Commissioner submitted that on the basis of the two judgments: "If a taxpayer becomes entitled to a right which has an ascertainable money value (and such right is not of a capital nature) the value of such right falls within the gross income of such taxpayer".

11. It was argued further that the appellants obtained the right to utilise the money lent and that this right had a money value. The Commissioner made the following submission:

> "In the case of the Appellants which conduct the business of developers of housing schemes for retired persons, the property units are their capital and they employ this capital by granting the use thereof to the occupiers. The rewards which they get in exchange for granting the use of such capital are the rights which they acquire to use the interest free loans from the occupiers. Therefore, as such rights have an ascertainable money value, such value falls within gross income."

12. In our view the reasoning of the Commissioner is fatally flawed. What the appellants received were sums of money which they were liable to repay on the happening of certain specified events. Until the happening of such events the appellants were entitled to use the monies received by them. These monies became loan capital which could be utilised either for the purpose of creating income or for the purpose of building units or for such other purpose as the appellants might wish. If the monies obtained were used for income producing purposes then obviously the appellants would have received income and would in the normal course have been taxable on such income. However, the monies were not used for these purposes and the Commissioner has assessed them on the basis of notional income received from the use of this money. This clearly is not permissible and such notional income is not income within the definition of section 1 of the Act.

13. The "rights" which the Commissioner alleges the appellants obtained are not rights which can be transferred or ceded. The only right which the appellants obtained was the right to retain the money lent until the happening of certain predetermined events. This "right" has no independent existence separate from the actual liability to repay the monies borrowed and clearly has no money value. What is of value is the possession of the money borrowed. Possession of money cannot in itself earn income as it is merely an income producing tool which may be used by the possessor to earn income but need not be so used. What the Commissioner has attempted to do is to treat the opportunity to earn income as income. This merely has to be stated to be rejected as not falling within the definition of "gross income" as explained in the cases cited above.

14. If the Commissioner's approach were correct it would mean that if a merchant sold stock-in-trade and utilized the proceeds to buy other stock he would be liable to pay tax on the interest he could have earned on such money. This simple analogy illustrates the fallacious reasoning of the Commissioner's arguments.

15. Where parties enter into a contract for the loan of monies, there can be no "amount received by or accrued to" the borrower, merely because the contract specifies that there will be no interest, or that the interest rate will be set at a certain rate. The obtaining of the loan capital by the borrower itself is certainly a receipt, but is not "gross income" as it is of a capital nature (see CIR v Genn and Co Ltd 1955 (3) SA 293 (A), and Meyerowitz on Income

Tax, 2003-2004 edition, at para 6.16). If a contractual aspect of such a loan makes it less or more valuable to the borrower, either at the date advanced, or at a later date, this simply affects the potential utility of this capital receipt in his hands, but does not in itself increase or decrease his gross income. If he is charged a relatively low rate of interest, and if he uses this capital wisely, and uses it in a manner that generates taxable income, his future taxable income will be higher than would have been the case had he paid a higher rate of interest. If he chooses to invest the capital in a manner that does not generate taxable income at all, then his taxable income will not have been influenced by the interest rate. This is the only relevance of the interest rate to the borrower's taxable income, and this aspect is not a matter before this court. Finally, to state the obvious, the level of the lender's receipts and accruals will be affected by the presence or absence of interest, and if present, its rate, but this aspect is also not a matter before this court. Thus, the Commissioner's reasoning is not valid.

16. In view of our finding that the Commissioner was incorrect in the manner in which he assessed the appellants it is not necessary for us to deal with the submission in regard to the assessment of (one of the Appellants) that the "revised" assessment in respect of the 1996 to 1998 years of assessment were not permissible in terms of section 79(1) of the Act as they were raised after the expiry of 3 years from the original assessment of the appellant.

17. We accordingly make the following order:

The appeal is upheld and the assessments appealed against are set aside.

On behalf of Mr I B **Skosana (Accounting Member) (Commercial Mr M van Blerck Member) and myself**

LI GOLDBLATT - PRESIDENT

This judgment should be reported YES 7/4/2005

Mr C van Breda instructed by PriceWaterhouseCoopers appeared on behalf of the appellant.

Mr M Jorge and Ms ED Battheu appeared on behalf of SARS