

Reportable

IN THE TAX COURT - DURBAN

CASE NO 11661

In the matter between

Appellant

and

COMMISSIONER FOR THE SOUTH AFRICAN
REVENUE SERVICE

Respondent

J U D G M E N T

24 May 2006

LEVINSOHN DJP:

For ease of reference I shall refer to the parties to this appeal as the taxpayer and the Commissioner respectively.

The taxpayer is a manufacturer and distributor of certain products. It carries on business at A, KwaZulu-Natal. The taxpayer sells its products to various wholesalers. These sales

are subject to the taxpayer's standard conditions of sale. For purposes of this appeal the relevant terms are set forth in clause 1 and more particularly 1.1 which reads: -

"Unless otherwise stated, all prices are net, and Value Added Tax is additional. Payment must be made by PURCHASER to SELLER without deduction, set off or demand at SELLER's address.

1.2

1.3 Should payment be made by PURCHASER to SELLER not later than the 25th day (or earlier full business day) of the month following the month during which delivery takes place, the PURCHASER shall be entitled to deduct a settlement discount from his payment, in accordance with SELLER's discount scheme, which may be revised by SELLER from time to time."

Certain relevant documentation issued by the taxpayer has been included in the papers before us. Firstly, there is a statement of account (in fact,

page 8 of the monthly statement) issued to a customer B (Pty) Ltd. This document is annexed to this judgment as "A". Secondly, invoice No 622710 dated 24th June 2003 for R276,78 is also annexed as "B".

In calculating its gross income as at 30th June 2003 the taxpayer listed its debtors in the following way. It recorded the gross selling price excluding VAT and deducted the applicable settlement discount therefrom; the latter amounts being termed "provisions". In other words the taxpayer for purposes of calculating its gross income as at the end of June 2003 would regard the net amount after deduction of the said discount as reflecting its gross income for that year. The assumption made is that the debtor would pay its account within the stipulated period and therefore be entitled to deduct the settlement discount. It is in that sense that the term "provisions" is used. The total amount of the so-called provisions as at 30th June 2003 was R4 371 015,38.

In respect of the financial year ending 30th June 2003 the Commissioner raised an additional assessment adding back the said amount of R4 371 015,38 to the taxpayer's gross income.

The taxpayer's objection to the additional assessment was disallowed. Hence the appeal to this Court.

The crisp issue is whether the so-called settlement discounts form part of the taxpayer's gross income during the financial year in question.

Section 1 of the Income Tax Act defines gross income as follows: -

"'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;

during such year or period of assessment, excluding receipts or accruals of a capital nature

One is concerned with whether there has been "an accrual". "Accrues to" means that a person becomes entitled to that amount irrespective of whether it is immediately enforceable or not.

See: ***Lategan v Commissioner for Inland Revenue*** 1926 CPD 203;
Commissioner for Inland Revenue v People's Stores (Walvis Bay) (Pty) Ltd 1990 (2) SA 353, especially at 365.

Mr *Shaw*, who appears on behalf of the taxpayer, has submitted that whether there has been an accrual depends upon a construction of the sales agreement. Counsel then contends, and it is convenient to quote from his heads of argument: -

"10. Those provisions have the effect that the right to the discounted amount accrues but there is no entitlement on the part of the Appellant to recover

the amount of the discount. That entitlement arises only if the relevant date has passed and the customer therefore is not entitled to the discount."

On closer analysis counsel contends for a twofold accrual. The first is the amount of the purchase price less the discount that accrues immediately and is rightfully part of the gross income in that financial year. The second element of the purchase price, namely the amount of the discount, can only accrue when the purchaser does not take advantage of the offer of a discount. Whether the purchaser pays on due date or not is an uncertain event and entitlement to the additional element of the purchase price, namely the discount, arises only then.

We consider that while counsel's argument is very attractive it cannot be accepted.

Clause 1.1 speaks of "payment". Payment in our view means payment of the amount invoiced in the

first place and in the second place appears on the statement. The agreement provides that if **payment** is made by a certain date the customer is entitled to deduct the discount. The invoice annexed is interesting. The customer is given a "volume" discount of 8%. After deduction of that discount the purchase price of R242,79 is reflected (excluding VAT).

The purchaser is informed that if that price is paid by 25th July 2003 it would be entitled to a "settlement" discount.

In our view "settlement" means settlement of the price indicated on the invoice. The statement of account as at 25th June 2003 annexed reflects the said invoice for R276,78 (including VAT). This statement interestingly enough also reflects a credit, "settlement discount" in an amount of R54 289,40 which in our view can only be in respect of its accounting date ending 25th May 2003. It shows in our opinion that the taxpayer debited the

full purchase price. Upon timeous payment the customer is only then given a credit. This is a clear pointer against Mr *Shaw's* submission for it indicates an intention on the part of the taxpayer to receive as at date of invoice and statement the amount of the invoiced purchase price. The manner in which the debtors' amount is reflected as at 30th June 2003, that is to say, the amount **less** the discount because of the so-called "provisions" is in our view wholly inconsistent with the taxpayer's existing accounting procedures. Dealing with its debtors as at 30th June 2003 in this way cannot, as counsel for the Commissioner submits, alter the situation nor indeed can entries in books of accounts ever transform an artificial state of affairs into reality.

We hold therefore that the accrual occurred as at the statement date in respect of the full invoiced amount. The Commissioner's contentions are

therefore correct, the assessment is confirmed and the appeal falls to be dismissed.