

## INTERPRETATION NOTE 117

DATE: 17 May 2021

**ACT : INCOME TAX ACT 58 OF 1962**  
**SECTION : SECTION 1(1) – DEFINITION OF “GROSS INCOME”**  
**SUBJECT : TAXATION OF THE RECEIPT OF DEPOSITS**

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#### ***Preamble***

In this Note unless the context indicates otherwise –

- “**section**” means a section of the Act;
- “**TA Act**” means the Tax Administration Act 28 of 2011;
- “**the Act**” means the Income Tax Act 58 of 1962; and
- any other word or expression bears the meaning ascribed to it in the Act.

All guides and interpretation notes referred to in this Note are available on the SARS website at [www.sars.gov.za](http://www.sars.gov.za). Unless indicated otherwise, the latest issue of these documents should be consulted.

## 1. Purpose

This Note provides guidance on the words “received by” in the definition of “gross income” in section 1(1) and the treatment of the receipt of a deposit in the ordinary course of business.

An examination of possible capital gains tax consequences attached to the receipt of a deposit does not form part of the scope of this Note.<sup>1</sup>

In addition, the Note does not deal with amounts deposited by clients with banks and similar deposit-taking financial institutions.

## 2. Background

In the ordinary course of business, taxpayers may receive money in advance in the form of deposits related to or for goods or services to be delivered or rendered at a future date.

Having regard to the definition of “gross income”, the facts of each transaction must be considered to determine whether a deposit should be included in gross income and, if so, in which year of assessment. In the context of deposits received in advance, one of the requirements which has in the past given rise to interpretational difficulties and resulted in the courts being called on to make a determination, is whether the physical receipt of a deposit means it has been received for purposes of the definition of gross income.

An aspect which may be relevant when a deposit is included in gross income is the availability of a deduction for any expenditure actually incurred in the production of that income or an allowance for future expenditure which meets all the requirements under section 24C. This aspect is not considered further in this Note.<sup>2</sup>

## 3. The law

### Section 1(1) – definition of “gross income”

**1. Interpretation.**—(1) In this Act, unless the context otherwise indicates—

“**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) in the case of any person other than a resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such person from a source within the Republic,

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—

...

<sup>1</sup> For more information, see the *Comprehensive Guide to Capital Gains Tax*.

<sup>2</sup> For more information on the interpretation and application of section 24C, see Interpretation Note 78 “Allowance for Future Expenditure on Contracts”.

## 4. Application of the law

### 4.1. Gross income

Section 1(1) defines “gross income”, in relation to any year of assessment, of a resident, as the total amount, in cash or otherwise, received by or accrued to or in favour of the resident, during such year of assessment, excluding receipts and accruals of a capital nature.

An amount which is not of a capital nature or which is specifically included in gross income irrespective of its capital nature<sup>3</sup> must be included in gross income in the year or period of assessment in which the amount was received or accrued, whichever is earlier.<sup>4</sup> The taxpayer will not be taxed on the same amount twice.

For purposes of this Note, only the words “received by” are considered.

#### *Received by*

In *Geldenhuys v CIR* Steyn J stated that “received by” means –<sup>5</sup>

“received by the taxpayer on his own behalf for his own benefit”.

Steyn J went on to state that –<sup>6</sup>

“[t]hrough the usufructuary received the purchase price of the sheep she did not become entitled to the money, which remained the property of the remainderman. In my opinion, it never became part of her ‘gross income’ ...”.

Schreiner JA stated the following in *CIR v Genn & Co (Pty) Ltd*:<sup>7</sup>

“It is difficult to see how money obtained on a loan can, even for the purposes of the wide definition of ‘gross income’, be part of the income of the borrower, any more than the value of the tractor which a farmer borrows is to be regarded as being income received otherwise than in cash. ... Neither in the case of the borrowed tractor nor in the case of the borrowed or ‘hired’ money does it seem to accord with the ordinary usage to treat what is borrowed or hired as a receipt within the meaning of the definition of ‘gross income’... It certainly is not every obtaining of physical control over money or money’s worth that constitutes a receipt for the purposes of these provisions. If, for instance, money is obtained and banked by someone as agent or trustee for another, the former has not received it as his income. At the same moment that the borrower is given possession he falls under an obligation to repay. What is borrowed does not become his, except in the sense, irrelevant for present purposes, that if what is borrowed is consumable there is in law a change of ownership in the actual things borrowed.”

These cases confirm that amounts received by a taxpayer on the taxpayer’s own behalf for the taxpayer’s own benefit are “received by” the taxpayer for purposes of gross income and that an amount received on behalf of a third party must not be included in the taxpayer’s gross income, since it is received on behalf of another party. In addition,

<sup>3</sup> See the definition of “gross income” in section 1(1) for specific inclusions which are not relevant to this Note.

<sup>4</sup> *SIR v Silverglen Investments (Pty) Ltd* 1969 (1) SA 365 (A), 30 SATC 199.

<sup>5</sup> 1947 (3) SA 256 (C), 14 SATC 419 at 430.

<sup>6</sup> 1947 (3) SA 256 (C), 14 SATC 419 at 434.

<sup>7</sup> 1955 (3) SA 293 (A), 20 SATC 113 at 122 and 123. In this judgement the Court, in considering the deductibility of specified expenses, considered the meaning of a receipt for purposes of the definition of gross income.

a loan subject to an immediate obligation to repay the amount, is not received for the purposes of gross income.

In *MP Finance Group CC (In Liquidation) v C: SARS*<sup>8</sup> the court considered the question of whether deposits taken in an illegal and fraudulent pyramid scheme constituted amounts “received” within the meaning of gross income. The taxpayer argued that because the scheme was liable in law to return the deposits, there was no basis on which it could be said that they were “received” within the meaning of the Act. The court rejected this argument, stating the following:<sup>9</sup>

“An illegal contract is not without all legal consequences; it can, indeed, have fiscal consequences.<sup>10</sup> The sole question as between scheme and *fiscus* is whether the amounts paid to the scheme in the tax years in issue came within the literal meaning of the Act.<sup>11</sup> Unquestionably they did. They were accepted by the operators of the scheme with the intention of retaining them for their own benefit. Notwithstanding that in law they were immediately repayable, they constituted receipts within the meaning of the Act. In other words it does not matter for present purposes that the scheme was not entitled, as against the investors, to retain their money. What matters is that what they took in was income received and duly taxable.”

Accordingly, if a taxpayer’s intention in receiving an amount is to receive it for the taxpayer’s own benefit, such amount constitutes a receipt for purposes of gross income, even if the taxpayer has an immediate legal obligation to repay it and is not legally entitled to the amount.<sup>12</sup>

## 4.2 Meaning of deposit

For purposes of this Note, the following dictionary meanings of “deposit” can be used to describe the word:

- “a sum of money which is part of the full price of something, and which you pay when you agree to buy it”;<sup>13</sup>
- “a sum of money which you pay when you start renting something. The money is returned to you if you do not damage what you have rented.”;<sup>14</sup> and
- “Down payment, advance payment, prepayment instalment . . .”.<sup>15</sup>

A deposit is a particular type of receipt or accrual.

Depending on the terms of the contract, the deposit may be refundable, refundable only under specified conditions or set off against the price of goods when they are delivered or when the services are rendered in future. A deposit is not a loan.

<sup>8</sup> 2007 (5) SA 521 (SCA), 69 SATC 141.

<sup>9</sup> At 145.

<sup>10</sup> *CIR v Insolvent Estate Botha* 1990 (2) SA 548 (A) at 556C-557B, 52 SATC 47.

<sup>11</sup> *Ibid* at 557I – 558A, 52 SATC at 58.

<sup>12</sup> For a detailed analysis of the taxation of stolen money, see Interpretation Note 80 “The Income Tax Treatment of Stolen Money”.

<sup>13</sup> [www.collinsdictionary.com/dictionary/english/deposit](http://www.collinsdictionary.com/dictionary/english/deposit) [Accessed 17 May 2021].

<sup>14</sup> [www.collinsdictionary.com/dictionary/english/deposit](http://www.collinsdictionary.com/dictionary/english/deposit) [Accessed 17 May 2021].

<sup>15</sup> Maurice Waite *Concise Oxford Thesaurus* 2 ed (2002) Oxford University Press.

### 4.3 Types of deposits

Deposits can be received in the ordinary course of business for a variety of types of transactions. The types of deposits considered below are not an exhaustive list and represent only the most common commercial deposits. The general principles considered in 4.1 must be applied to determine whether a deposit should be included in gross income and in which year of assessment.

#### 4.3.1 Returnable containers

Taxpayers may charge deposits to customers for containers supplied with goods. These deposits are generally refundable if the customers return the containers in good condition.

In *Pyott Ltd v CIR*<sup>16</sup> the taxpayer charged a separate amount for tins containing biscuits sold to customers. The customers had the option of returning the tins which would entitle them to a refund of the sum charged for tins by the taxpayer if they were returned in good condition. In an *obiter dictum* the court agreed with the admission that deposits were not trust moneys and commented that if they were, they would not be part of the taxpayer's income. The taxpayer was unsuccessful in trying to argue that the amount should not be included in gross income because it should either be valued at less than the amount of cash received or that a deduction should be allowed for the contingent obligation to pay the customer if the container was returned.

In *Brookes Lemos Ltd v CIR*<sup>17</sup> the taxpayer manufactured and sold fruit squashes and other foodstuffs in glass containers and charged deposits for the glass containers which were refundable upon return of the containers by the customers. There was no obligation on a customer to return the container. The money received was used by the taxpayer in its business and was not deposited into a trust account. It was held that the deposits became the absolute property of the taxpayer and the fact that the taxpayer undertook to refund the deposit if and when the customer returned the container did not change this fact or make the taxpayer a trustee with regard to the deposit. The amounts were held to have been received for purposes of gross income.

In response to the taxpayer's contention that the deposits were security or amounts held in trust and therefore had not been received for purposes of gross income, Watermeyer CJ commented as follows:<sup>18</sup>

"If such amount is really received as trust moneys, of which the recipient is not the beneficial owner but merely a trustee, then doubtless Mr Duncan's contention is correct, but that position does not exist here. The appellant was not a trustee holding the deposits on account of the customers as security for the return of the bottles. Even if the relationship between customer and company could, in common parlance, be loosely so described, it was not such in law. There was no obligation to return the container resting on the customer and the deposit was not a security in the nature of a pledge given to secure performance of such an obligation. Consequently the seller was in no sense a trustee or pledgee. On the contrary the deposits became the absolute property of the Company and they could use them as they pleased; and the fact that they had undertaken an obligation to pay to such of their customers as returned containers an amount equivalent to the amount which they had paid as deposits on

<sup>16</sup> 1945 AD 128, 13 SATC 121.

<sup>17</sup> 1947 (2) SA 976 (A), 14 SATC 295.

<sup>18</sup> At SATC 299.

similar containers did not constitute the company a trustee with regard to those deposits.”

The above principles were confirmed in *Greases (SA) Ltd v CIR*.<sup>19</sup> In this case, the taxpayer, a company, supplied grease in drums and charged deposits for the drums which were refundable should the customer return the drums. The drums remained the property of the taxpayer but the court also found that factually there was no obligation to return the drums to the taxpayer. The deposits, which were booked to a suspense account in the accounting records, were used by the taxpayer in its business and not placed in a separate trust bank account. The court held that these amounts were received for purposes of gross income, since the amounts were received by the taxpayer for its own benefit, the taxpayer was entitled to use the amounts in its business and the amounts were not held in trust for the customer. The court held that the taxpayer’s contingent obligation to pay customers that returned a drum an amount equal to the deposit did not mean that the deposits were held as trustee on behalf of the customers.

In relation to the finding that there was no trust relationship, Centlivres CJ commented as follows:<sup>20</sup>

“I do not think that the appellant’s customers ever intended that, when they paid their deposits, such deposits should be held in trust for them by the appellant and that the appellant should not have the right to mix those deposits with its own money and to use them for any purpose it might deem fit. It is interesting to note that in the later case of *Jay’s The Jewellers Ltd. v Inland Revenue Commissioners*, [1947] 2 All E.R. 762, and 29 Tax Cases 274, to which Mr *Ettlinger* also drew our attention, Atkinson, J., in commenting at p. 765 of the All England Reports on *Morley v Tattersall* said that

‘as a matter of law, these moneys when received (by Tattersalls) were not the taxpayers’ moneys at all; they belonged to their clients and if a client came in the next day and demanded his money they would have to pay it away’.

That is not the position in the present case: here there was an obligation on the part of the appellant to pay a customer a sum equivalent to the deposit he had made when the customer tendered to it a usable drum.”

Otherwise stated, the obligation to pay a sum equivalent to the deposit when the customer returned a usable drum was a contingent obligation for the taxpayer which materialised if the customer returned a usable container and did not indicate a trust relationship in relation to the deposit on receipt.

A separate bank account or strict record-keeping which separately identifies the funds is insufficient on its own to exclude a deposit from being regarded as received for purposes of the definition of “gross income”. For example, if the taxpayers in *Pyott Ltd v CIR*,<sup>21</sup> *Brookes Lemos Ltd v CIR*<sup>22</sup> and *Greases (SA) Ltd v CIR*<sup>23</sup> referred to above, having received the money for their own benefit and being entitled to use it as they deemed fit, decided to put it in a separate bank account to ensure they had money to pay the deposit should the customer return the relevant containers, the deposit would

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<sup>19</sup> 1951 (3) SA 518 (A), 17 SATC 358.

<sup>20</sup> At SATC 365.

<sup>21</sup> 1945 AD 128, 13 SATC 121.

<sup>22</sup> 1947 (2) SA 976 (A), 14 SATC 295.

<sup>23</sup> 1951 (3) SA 518 (A), 17 SATC 358.

still have been regarded as having been received for purposes of gross income. This principle was confirmed in ITC 1918<sup>24</sup> when Binns-Ward J stated the following:

“That is, were the payments received and held in a manner that, in a legally effective way, distinguished the funds segregated in the separate bank account from the taxpayer’s property? As with English law, so too with us, merely segregating the funds, as the taxpayer did in the current matter, would not, by itself, be enough. A cognisable legal context, such as the establishment of a trust, the terms of a will, or the existence of a principal-agent relationship, is necessary to give the segregation of the funds the effect of putting them outside the holder’s estate, avoiding the ordinary incidence of *commixtio*. Absent such a context, I am unable to conceive of how a prepayment to the taxpayer for goods to be sold by it later could differ in its proprietary effect from a contemporaneous payment in the context of a cash sale. The money becomes that of the contemplated or actual seller as soon as it is paid over. It does not matter where it keeps it, or how it accounts for it in its books. It may spend it or save it as it wishes.”

Each case must be decided on its own facts. For a deposit to be excluded from gross income on the basis that it has not been received by the taxpayer, the amount must not be the taxpayer’s money, for example, it is held for a principal in a principal-agent relationship. The taxpayer must have no right to retain the deposit as the taxpayer’s absolute property. The legislation does not specifically state that for an amount not to be regarded as having been received by a taxpayer for the taxpayer’s own benefit, it must be held in a separate trust account. However, the cases mentioned above and in 4.1, indicate that, although not absolute, the absence of a separate trust account will often indicate that factually either a) the parties to the transaction regarded the amount as having been received by the taxpayer for the taxpayer to use as the taxpayer deemed fit and not as being held in trust for the counter-party, or b) that notwithstanding that the counter-party intended there to be a trust relationship, that the taxpayer had the intention of retaining the money for the taxpayer’s own use and therefore the taxpayer received it as gross income.

The use of a separate bank account for deposits does not in itself override the true nature of the transaction and intention of the taxpayer.<sup>25</sup> Thus, even if the taxpayer keeps the deposits in a separate bank account but there is no intention of refunding them, they must be included in gross income in the year of assessment in which they are received.

The decisions in *Pyott Ltd v CIR*,<sup>26</sup> *Brookes Lemos Ltd v CIR*<sup>27</sup> and *Greases (SA) Ltd v CIR*<sup>28</sup> support the view that an amount which has been received by a taxpayer for the taxpayer’s own benefit and which may be used by the taxpayer in the business must be included in gross income notwithstanding that the taxpayer may have undertaken a contingent obligation to repay all or a portion of the receipt under specified circumstances which may or may not happen, assuming receipt precedes accrual.

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<sup>24</sup> (2019) 81 SATC 267 (C) at 280 and 281.

<sup>25</sup> *MP Finance Group CC (In Liquidation) v C: SARS*, 2007 (5) SA 521 (SCA), 69 SATC 141.

<sup>26</sup> 1945 AD 128, 13 SATC 121.

<sup>27</sup> 1947 (2) SA 976 (A), 14 SATC 295.

<sup>28</sup> 1951 (3) SA 518 (A), 17 SATC 358.

ITC 1346 did not deal with returnable containers; however, Schock J referred to the *Brookes Lemos* and *Greases* cases and said that the decisions in those cases –<sup>29</sup>

“clearly show that once the taxpayer receives an amount as his own during a tax year, the fact that in terms of his contract he may, in certain circumstances, have to repay the same later, does not have the effect of excluding these amounts from his ‘gross income’ for the year in which he received same”.

Similar to the deposit cases mentioned above, it was held in this case that notwithstanding that the taxpayer had a contingent liability to potentially refund a portion of the amount received, the full amount was nevertheless received by the taxpayer for the purposes of the definition of “gross income”.

Returnable container deposits as considered above are distinguishable from security deposits (see **4.3.4**).

### **4.3.2 Rental deposits**

Under property lease agreements a lessor will usually require that the lessee pays a rental deposit (sometimes also referred to as a security deposit) on entering into a lease agreement.

The Rental Housing Act 50 of 1999 (the Rental Housing Act) applies to the leasing of a dwelling which includes a house, hostel room, hut, shack, flat, apartment, room, outbuilding, garage or similar structure, including any store-room, outbuilding, garage or demarcated parking space which is part of the leased property.<sup>30</sup> Thus the Rental Housing Act does not apply to the rental of commercial property.

Section 5(3) of the Rental Housing Act deems a lease to include certain terms and, among others, includes the following:

- The landlord may require the tenant to pay a deposit before moving into the property.
- The deposit must be invested by the lessor in an interest-bearing account with a financial institution.
- On expiration of the lease agreement, the lessor may apply the deposit and interest towards the payment of all amounts for which the lessee is liable under the lease agreement, such as reasonable costs of repairing damage caused to the property during the lease period and the cost of replacing lost keys. The balance of the deposit and interest must then be refunded to the lessee by the lessor not later than 14 days of restoration of the property to the lessor.
- Should no amount be due and owing to the lessor on expiration of the lease, the deposit with the accrued interest must be refunded to the lessee within seven days of expiration of the lease.

Since the above terms are deemed to be included in a lease, the parties to the lease agreement are bound by them whether they are explicitly included in the agreement or not.

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<sup>29</sup> (1981) 44 SATC 31 (C) at 32.

<sup>30</sup> Definition of “dwelling” in section 1 of the Rental Housing Act 50 of 1999.

The same income tax principles, see below, generally apply to rental deposits irrespective of whether the lease is governed by the Rental Housing Act. It is, however, necessary to evaluate the specific contract before a final conclusion is reached.

While the wording of the specific lease agreement is critical, a lessor generally receives the deposit in the position of a trustee and, since the rental deposit is not the lessor's money, has an immediate obligation on receipt of the rental deposit to refund it to the lessee upon termination of the lease. Typically, the lease agreement provides that if the lessee does not meet all of the lessee's obligations as set out in the agreement, for example, the lessee owes the lessor an amount for rental for prior months, the amount owing by the lessee may be set off against the rental deposit with the net amount being refunded to the lessee. Since the deposit is not the lessor's money and the lessor is contractually liable to refund the rental deposit at the time it is received, the amount is not received by the lessor "on his own behalf for his own benefit" and thus is not included in the lessor's gross income. If the lessee owes the lessor an amount under the lease, that amount will often represent gross income for the lessor (for example, a charge for repairs to be conducted by the lessor or outstanding rent). See Example 1 below.

The income tax treatment of a deposit that falls within the ambit of the Rental Housing Act is not necessarily altered by non-compliance with the deemed terms. For example, if a deposit is not invested with a financial institution in an interest-bearing account that does not automatically render the amount to be taxable provided the income tax requirements as considered above in this section of the Note are complied with.

#### **Example 1 – Deposits received by a lessor in terms of a lease agreement**

*Facts:*

A property owner entered into a lease agreement during the 2019 year of assessment and received a deposit of R10 000 upon the commencement of the lease. Under the lease agreement, the deposit is refundable upon expiry of the lease; however, to the extent the lessee has outstanding obligations owing to the lessor under the agreement, these may be set off against the deposit and the net amount refunded to the lessee.

Under the lease agreement the lessee was required to pay rent of R4 000 per month at the beginning of each month. The lessee was also, amongst other things, required to deliver the property back to the lessor upon termination of the lease agreement in the same condition as initially received. The lessee was required to make good any damage and breakages to the property, or in the alternative, the lessor could elect to make good such damage and breakages in which case the lessee would be liable to pay the related charges levied by the lessor.

Upon expiry of the lease in the 2020 year of assessment, the lessee had rent outstanding for one month and the lessor levied a charge of R3 000 to provide for damages and breakages. The lessee therefore had outstanding obligations as set out in the agreement. The outstanding rent of R4 000 and the charge for damage and breakages of R3 000 was set off against the deposit of R10 000 and the difference of R3 000 was refunded to the lessee.

*Result:*

The deposit received of R10 000 does not form part of the lessor's gross income in the 2019 year of assessment. Monthly rental of R4 000 is included gross income when it accrues to the lessor at the beginning of each month. The charge for damages and breakages of R3 000 levied by the lessor must also be included in gross income in the 2020 year of assessment as the lessor's entitlement to the amount represents an accrual for purposes of gross income.

Notwithstanding a possible perception that the portion of the deposit which was forfeited or not repaid is included in gross income, it is actually the underlying amount of rent and the charge for damages and breakages that is included in gross income. Set-off is a method of payment of the amounts outstanding for rental and for damage and breakages.

Whether the lessor qualifies for a deduction or allowance for expenditure incurred in attending to the damages and breakages will depend on the detailed nature of the expenditure and whether the requirements of a particular allowance or deduction are met. The requirements of the repairs and maintenance deduction under section 11(d) or the general deduction under section 11(a) will often be met.

A rental deposit is distinguishable from an up-front rental payment and a lease premium. The facts and circumstances of each case should be considered to determine whether the amount received constitutes a rental deposit, an up-front rental or a lease premium. The income tax treatment of a rental deposit is considered above. An up-front rental is for the use or occupation or right of use or occupation of the lessor's property and therefore remains in the nature of rent which is included in the lessor's gross income. A lease premium is usually an up-front amount paid for the use or occupation or right of use or occupation of a property and is not refundable. It represents an inclusion in gross income for the lessor. For a detailed consideration of lease premiums, see Interpretation Note 109 "Lease Premiums".

### 4.3.3 Agreements of sale or service

In ITC 707<sup>31</sup> the taxpayer received advance payments for funerals to be rendered at a later date. The court held that the advance payments constituted gross income, since they represented ordinary revenue income of the taxpayer's business and the taxpayer had at all material times dealt with the advance payments as his own money. The money went into the taxpayer's ordinary business account, it was not put into a trust fund or any special account and was used by him in the ordinary course of his business to either fund the running of the business or possibly to make investments for his own benefit.

In *C v COT*<sup>32</sup> the taxpayer, a company carrying on business as a fuel-selling and service station, experienced a change in industry business practice which required it to pay cash for its bulk fuel deliveries. To help fund this cash-payment requirement, the taxpayer gave its regular customers the option of paying cash for their purchases or to continue paying monthly for their purchases but only after paying a deposit equal to a 12<sup>th</sup> of their annual expenditure on fuel. The taxpayer intended the deposits to be in the nature of a loan. These amounts were deposited into the sole bank account of

<sup>31</sup> (1950) 17 SATC 224(C).

<sup>32</sup> 1984 (3) SA 210(ZS), 46 SATC 57.

the taxpayer and were used by the taxpayer for the payment of fuel, the purchase of spare parts and other expenses. The deposits were recorded as credits in each customer's name until the customer closed his monthly credit account facility, in which event the deposit became due for repayment immediately and the customer was entitled to demand repayment. The credits did not reflect on the customers' monthly statements and were not applied against monthly purchases made by customers. Upon request from customers the taxpayer provided documentary acknowledgement of the indebtedness to the customers' auditors. The taxpayer contended that the deposits were loans for consumption in its hands and this was their overall intention. It was held that the receipt of the deposits did not constitute ordinary revenue income but was "working capital" just as it would have been had a bank supplied the taxpayer with a loan. The fact that no interest was payable by the taxpayer and that there was no fixed date for repayment was irrelevant in this instance. The deposits were therefore not required to be included in gross income. While the court found that in this case the "deposit" was factually a loan, it is submitted that the substance of the transaction must always be taken into account and often in arrangements of this nature it is likely that the deposit will be an advance payment which is for the benefit of suppliers and must be included in gross income.

In ITC 702<sup>33</sup> the taxpayer, a company, which carried on the business of technical consultants and advisers in connection with the erection, construction, maintenance and operation of machinery and plant of all kinds, received an amount comprising payment for services rendered during the year of assessment as well as services to be rendered over a period of ten years. The taxpayer included only a portion of the amount received in gross income in the particular year of assessment. The Commissioner raised an assessment including the full amount received. The court held that the decision of the Commissioner was correct and, that since the amount received was not of a capital nature, it was received by the taxpayer in that year of assessment and should be included in taxable income for that same year.

A contract of sale or service delivery may have suspensive or resolute conditions. The conditions attached to the agreement and the various clauses of the agreement will determine whether and when a deposit, if applicable, must be included in gross income.

An agreement that contains a resolute condition comes into full force and effect on conclusion of the agreement, assuming there is no suspensive condition, and continues in existence unless and until the resolute condition is met, in which case the agreement is terminated on fulfilment of that condition. Since there is no suspension of the agreement, all rights and obligations come into effect on conclusion of the agreement. All the facts and the clauses of the agreement must be considered in determining whether the seller or service provider is entitled to the deposit for own benefit when it is received and, if so, it must be included in gross income in that year of assessment, or whether the deposit, for example, is held in a separate account on behalf of the purchaser or customer until a future date, in which case the inclusion in gross income would be delayed. If a deposit which was included in gross income becomes refundable as a result of a resolute condition being fulfilled and the agreement terminating, the refund of the deposit will generally be deductible under section 11(a) in the year of assessment in which the condition is fulfilled, provided all the requirements of that section are met.

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<sup>33</sup> (1950) 17 SATC 206 (N).

A contract subject to a suspensive condition is a valid contract from its conclusion. However, full operation is suspended pending the condition being met. Only on fulfilment of the condition is the contract of full force and effect and enforceable by the parties in accordance with its terms. Depending on the wording of the contract, a taxpayer receiving a refundable deposit under such a contract may, for example, become entitled to it when the suspensive conditions have been fulfilled or the contract could, for example, contain a clause which delays the taxpayer's entitlement until a later date. In the case of the receipt of a non-refundable deposit, such deposit would be included in gross income upon receipt of the deposit unless the amount accrued at an earlier date.

Absent an agreement having any resolutive or suspensive conditions, the clauses in the agreement relating to the deposit must still be considered to determine when the seller is entitled to the deposit for own benefit.

Deposits are common in the sale and purchase of immovable property. Although the particular contract must be considered, generally, when a purchaser pays a deposit in respect of the purchase of immovable property, it is paid into an estate agent or attorney's trust account and held in trust for the purchaser until such time as it is applied in partly settling the purchase price of the immovable property. Until it is applied in settling the purchase price, the money is the purchaser's property and any interest earned on it is generally included in the purchaser's gross income.<sup>34</sup>

This Note does not consider whether the full "proceeds" have accrued to the taxpayer under general principles or a specific section of the Act, such as section 24; these are aspects a taxpayer must consider.

#### **4.3.4 Security deposits**

Many taxpayers let equipment or goods as part of their business and require a deposit to be paid on acceptance of a quote to secure the booking as well as to cover any charges levied in the future for damage to the items or failure to return the assets.

It depends on the particular contract but as in the case of rental deposits (see **4.3.2**), security deposits are usually held in trust and are refundable by the taxpayer at the end of the contract, but may be set off against any amounts owing by the customer for damage to the item or failure to return the items timeously. In these circumstances, on receipt the money is not the taxpayer's and there is an unconditional obligation on the taxpayer providing the goods or equipment to refund the deposit. Therefore, the deposit is not received by the taxpayer "on his own behalf for his own benefit" and accordingly should not be included in the taxpayer's gross income on receipt. Any amounts the customer is charged for damages or failure to return the items timeously will generally be gross income for the taxpayer.

Accommodation establishments often charge a deposit to secure a booking. The deposit is then deducted from the balance of the accommodation fees payable and, subject to the establishment's cancellation policy, may be refunded in whole or in part upon cancellation of the booking. It depends on the particular contract, but as in the case of returnable containers (see **4.3.1**), deposits or advance payments of this nature are usually received by the taxpayer "on his own behalf for his own benefit" and

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<sup>34</sup> The implications of section 86 of the Legal Practice Act 28 of 2014 must be considered in the case of a trust account operated by a legal practitioner.

should be fully included in gross income on receipt. The establishment may become obliged at a later date to refund the deposit or part of it if the guest cancels the booking. If the deposit or a portion of it is refunded, a deduction of the refunded amount may be claimed by the establishment under section 11(a) in the year of assessment in which it is refunded, subject to the requirements of that section being met.

**Example 2 – Deposits received by taxpayer carrying on the business of a holiday resort to secure a future booking**

*Facts:*

A taxpayer carrying on the business of a holiday resort receives deposits to secure future bookings. The resort has a cancellation policy which stipulates that in the event of the cancellation of a booking more than one month preceding the date of commencement of the stay, 50% of the deposit is refundable. If cancelled one month or less before the stay, the full deposit is forfeited. The deposits are paid into the taxpayer's normal business account.

*Result:*

The full amount of deposits received form part of the taxpayer's gross income in the year of assessment in which they are received. The refund of the deposits is conditional based on the payer cancelling the booking more than one month preceding the date of the commencement of the stay. The amounts are not held in trust for guests.

#### 4.3.5 Construction and building contracts

In the construction and building industry it is common practice for advance payments to be required before the commencement of the work which will be executed. These payments, which may sometimes be referred to as a deposit, are generally available to the contractor to use to purchase building material or equipment and accordingly are received for own benefit and must be included in gross income.<sup>35</sup>

#### 4.3.6 Impact of the Consumer Protection Act on deposits

In ITC 1918<sup>36</sup> the taxpayer was a retailer that "sold" gift cards to its customers that could be redeemed at any of its stores. Although colloquially referred to as a "sale", the court found that the "sale" was actually a prepayment and the physical gift card merely vouched for the existence of a personal right against the taxpayer for redemption of the prepayment. In line with the principles considered earlier in this Note (see 4.3.1 for a quote from this case), the Court found that prior to considering the impact of the Consumer Protection Act 68 of 2008 (the CPA), there was no applicable trust relationship and the amounts would have been received by the taxpayer for purposes of gross income. This view was not altered by the fact that after performing the relevant reconciliations the taxpayer transferred and retained moneys for unredeemed gift card receipts in a separate bank account.

However, the Court found that the taxpayer was a supplier as defined in the CPA and that the "sale" was regulated by section 63 and section 65 of that Act. Section 63 provides that the consideration received is the property of the bearer of the gift card to the extent it has not been redeemed in exchange for goods or services. Section 65

<sup>35</sup> For more information on the interpretation and application of section 24C in the case of construction and building contracts, see Interpretation Note 78 "Allowance for Future Expenditure on Contracts".

<sup>36</sup> (2019) 81 SATC 267 (C).

provides that the supplier must not treat the consideration as the supplier's own and "in the handling, safeguarding and utilisation of that property, must exercise the degree of care, diligence and skill that can reasonably be expected of a person responsible for managing any property belonging to another person". The Court held that the CPA and the taxpayer's adherence to its requirements resulted in some form of statutory trust in which the cardholder is given a proprietary interest and the taxpayer has a fiduciary duty to the bearer. Otherwise stated, after applying and complying with the CPA, the taxpayer did not receive the money from the "sale" of gift cards on its own behalf for its own benefit and it should not be included in gross income. Binns Ward J stated the following:<sup>37</sup>

"... if the manner in which the CPA protects consumers entails the deferral of beneficial receipt of revenue by suppliers as a matter of fact, then the knock-on effect on the determination of the suppliers' taxable income is only to be expected."

ITC 1918 is relevant because it highlights that if the provisions of the CPA apply and are fully complied with, the outcome otherwise achieved in applying the general principles considered in this Note may be different. The specific facts and circumstances of each case, the relevant provisions of the CPA and the taxpayer's compliance with the requirements of the CPA must be considered in determining whether an amount should be included in gross income. If the taxpayer did not comply with the provisions of the CPA, the general principles considered in this Note may prevail.

An analysis of the impact of the CPA on the principles considered in this Note is outside the scope of this Note.

## 5. Unclaimed deposits

The treatment of an unclaimed deposit depends on its prior treatment for income tax purposes. For example, if a rental deposit, which was not included in the lessor's gross income under the principles considered in this Note at the time it was received **or prior to prescription**,<sup>38</sup> is for some reason never claimed by a previous lessee, then after the relevant prescription period when the deposit becomes the lessor's money, it must be included in the lessor's gross income.

See sections 10, 11 and 12 of the Prescription Act 68 of 1969 regarding the periods of prescription and the date on which debts prescribe. The prescription period generally commences from the date on which the debt becomes due, however, there are a few exceptions to this rule.

In contrast, if a customer pays a deposit for the supply of goods in the future and under the principles considered in this Note the deposit was received by the supplier for own benefit and included in gross income when received, then if the goods are not supplied and the customer does not claim the deposit, it will not be included in gross income again. If the supplier refunds the deposit, it may constitute a deductible expense for the supplier.

<sup>37</sup> (2019) 81 SATC 267 (C) in [42].

<sup>38</sup> For example, a taxpayer's intention towards a deposit that was not initially received by the taxpayer for own benefit and on own behalf (and accordingly was not initially included in gross income) may change in the future to keeping the deposit for own benefit notwithstanding that it is legally owing to the lessee and requiring inclusion in gross income at that point in time.

## **6. Conclusion**

This Note deals only with general principles. The facts and circumstances of each case, including the conditions attached to the deposit and the intention of the taxpayer, must be considered.

Deposits received by a taxpayer must be included in the taxpayer's gross income if received by the taxpayer "on his own behalf for his own benefit". For a deposit to be excluded from gross income on the basis that it has not been received by the taxpayer, the amount must be held in trust and generally be held in a separate bank account. The use of a separate bank account, however, does not override the true nature of the transaction and intention of the taxpayer. Thus, even if the taxpayer keeps the deposits in a separate bank account but there is no intention of refunding them, they must be included in gross income in the year of assessment in which they are received.

If applicable, the consequences of the CPA and any obligations it places on a taxpayer must be considered in determining whether a deposit must be included in a taxpayer's gross income.

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