

The South African income tax implications of a Stokvel

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Abstract

The term “Stokvel” originates from the rotating cattle auctions of English settlers in the Eastern Cape during the nineteenth century. A Stokvel is defined as a credit union where a group of people agree to contribute a fixed amount of money to a common pool and is referred to as a rotating savings and credit association, where the contributions to a fund are given in whole or in part to each member. The goal of the thesis was to determine the “gross income” implications of the fund and its members, as well the deductibility of their expenses.

An interpretative research approach was used in the research as it sought to understand and describe. No interviews were conducted for this research and the data used for the research are publicly available. The tax implications of five different types of a Stokvel were considered in relation to the research goals through the application of legislation and case law principles.

The study established that a collection burial society, where funds are contributed after death, does not beneficially receive funds and it is not entitled to any deductions. The same applies to the member of that society. A contributing burial society, where funds are contributed over time, beneficially receives funds, which are included in “gross income”, and qualifies for deductions. The receipt by the member is exempt and deductions are prohibited by section 23(f). An entertainment Stokvel does not receive the contributions on its own behalf and benefit. No deductions are available to it. However, the member beneficially receives the contributions from the Stokvel, which are included in “gross income”, and qualifies for deductions. A purchasing power group, where items are purchased on behalf of members, does not receive the funds beneficially and no deductions are available to it. The members simply receive the goods they have paid for. Lastly an investment Stokvel, which invests contributions for the members, beneficially receives contributions and qualifies for various deductions. The member receives the share of income from the Stokvel for his/her own benefit. However, no deductions are available in respect of contributions.

Key words: Stokvel; income tax; gross income; general deduction formula

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CHAPTER 1:INTRODUCTION

1.1 Context of research

The term “Stokvel” originates from the rotating cattle auctions or “stock-fairs” of English settlers in the Eastern Cape during the nineteenth century. It was during those “stock-fairs” that black farmers and labourers in attendance exchanged ideas and gambled whatever resources they had (Lukhele, 1990:4). Irving (2005:10), citing Schulze (1996) and Verhoef (2001), mentions that the black farmers and labourers in attendance at the “stock-fairs” would “sometimes club money together to purchase livestock.”

Stokvels have evolved over time. African Response (2012:2) citing Mboweni (1990) states that:

the evolution and growth of Stokvels post the stock fair era has been associated with the need for survival strategies to mobilize financial resources, which former South African Reserve Bank Governor Tito Mboweni argues were initiated by the disadvantaged black community during South Africa’s previous dispensation in a bid to cope with economic oppression grounded in race and class exploitation.

According to Calvin and Coetzee (2010:1), “defining Stokvels has been contentious as a wide variety of Stokvels exist.” Irving (2005:10) argues that the problem in defining Stokvels “stems in part from a genuine absence of clear boundaries in operation and functions between the different type of groups.” Nonetheless Lukhele (1990:1) defines a Stokvel as:

a type of credit union in which a group of people enter into an agreement to contribute a fixed amount of money to a common pool weekly, fortnightly or monthly. Then, depending on the rules governing a particular Stokvel, the money, or a portion thereof, may be drawn by members either in rotation or in a time of need.

Depending on the regional location, in South Africa different names are used to describe Stokvels, which include names such as *gooi-goois*¹, *mohodisano*², *makgotla*³ and *kuholisana*⁴ (Kibuuka, 2006:18; African Response, 2012:2). The definition of a Stokvel incorporates elements of rotation and retention. In South Africa Stokvels are generally referred to as informal voluntary savings group organisations, which are regarded as rotating savings and credit associations (ROSCA) (Verhoef, 2002:2). Irving (2005:11), citing Arderner (1964), mentions that a ROSCA is defined as “an association formed upon a core of participants who agree to make regular contributions to a fund which is given, in whole or in part, to each contributor in rotation.”

The money contributed to a Stokvel may be used for savings, groceries, funeral costs, investments or entertainment purposes (Irving: 2005; Lukhele: 1990; Wegelin: 2016). Existing research indicates that the Stokvel market has been growing since the inception of Stokvels as informal saving groups. The African Response (2012:4), citing Lukhele (1990) and Townsend and Masola (2009), notes that the number of South Africans belonging to Stokvels was reported as 10.5 million in 2003, resulting in R12 billion spending power. In 2012, the spending power of Stokvels was reported as R44 billion (African Response, 2012:14) and in 2017 Fin24 (Online) reported that the Stokvel market stood at R49 billion.

Despite the reported growth and size of the Stokvel market there is a perception that Stokvels are informal in how they operate. Sanlam (Online) mentions that the main concern when it comes to doing business with Stokvels, especially from a corporate perspective, is the informal nature and the perception that Stokvels are unstructured. Kibbuka (2006:4) states that “operators in the informal sector largely do not operate out of offices, maintain few or no records at all, thereby reducing the processing time of transactions.”

¹ Gooi is an Afrikaans term for throwing which has been adapted in the Stokvel context to refer to the act of pooling or lumping money (African Response, 2012:2)

² Mohodisano is a Sotho term meaning paying each other (African Response, 2012:2)

³ Makgotla is a plural word for Lekgotla, which is a Tswana word used to describe any social gathering with a good purpose, such as a birthday or burial society gathering (Lukhele, 1990:16)

⁴ Kuholisana is a Zulu term meaning paying each other, similar to Mohodisano (African Response, 2012:2)

Although Stokvels may be viewed as informal in nature, the way they operate may indicate an element of formality. Wegelin (2016:30) mentions that Stokvels are usually governed by a constitution, with some constitutions being very detailed and “drafted by people with a legal background and others are a mere basic set of rules and principles.” The constitution may prescribe three key positions in any Stokvel, namely the chairperson, the secretary and the treasurer. Wegelin (2016:30) mentions that when Stokvel meetings are convened, there is usually a standard agenda which may include money matters, review of the financial records, monthly and missed contributions and new memberships.

From an income tax viewpoint, specifically considering the “gross income” definition in section 1 of the Income Tax Act No. 58 of 1962 (hereafter referred to as the Income Tax Act), the question must be addressed whether the contributed funds and other amounts are included in the “gross income” (as defined in section 1 of the Income Tax Act) of the Stokvel or its members. For an amount to be eligible to be taxed, it must meet the definition of gross income. In relation to that definition, Stiglingh, Koekermoer, van Zyl, Wilcocks and de Swart (2017:14) mention that four requirements must be satisfied for an amount to be treated as gross income, these being the “total amount”, “received by or accrued to or in favour of” . . . , “during the year of assessment” and “not of a capital nature” elements. Since the gross income requirements are not defined in the Income Tax Act, case law must be consulted in applying these requirements. Therefore, the first research goal of the thesis is to discuss the “gross income” definition in relation the Stokvels and their members.

The reported spending power of Stokvels raises the question whether amounts spent by these associations or their members qualify to be deducted from income, for income tax purposes. The operational needs of a Stokvel may result in running costs. For instance, Massmart assists purchasing power groups to acquire the best deals that are suited to the Stokvel needs, providing transport services for the grocery items that may be purchased (Massmart, Online). In terms of the preamble to section 11 of the Income Tax Act, for a taxpayer to qualify for deduction of expenses and losses against income, the taxpayer must firstly be “carrying on a trade”. The phrase “carrying on a trade” is not defined in the Income Tax Act, and therefore case law will have to be consulted in order to gain an understanding. Thereafter the requirements of section

11(a) read together with section 23(g) must be satisfied: “expenditure or losses, actually incurred in the production of the income and not of a capital nature” (the so-called general deduction formula). Many of these expressions similarly are not defined and have been interpreted by the courts. Section 23(g) prohibits “any moneys, claimed from income derived from trade, to the extent to which such moneys were not laid out or expended for the purposes of trade.” Therefore, the second research goal of the thesis is to discuss whether the expenses incurred by a Stokvel qualify for deduction in terms of the “general deduction formula”.

The Davis Tax Committee (2016:7) recommended that “further investigation of the taxation implications of cooperative societies is necessary.” Under the heading “Co-operative societies ‘Stokvels’”, the Davis Tax Committee reported that “the DSBD [Department of Small Business Development] has expressed its concern that the first [Davis Committee] report has failed to address the taxation implications of co-operative societies.” This thesis therefore aims to contribute to the further investigation of the taxation implications of Stokvels.

1.2 Goals of the research

The goal of the research is to discuss the South African income tax implications of a Stokvel. In addressing this research goal, the following sub-goals will be addressed:

- assessing whether the contributed funds and other income constitute “gross income” of the Stokvel; where amounts are “received by or accrue to or in favour of” a Stokvel, the “capital or revenue” nature of the amount will be discussed briefly;
- assessing whether the funds and other income flowing from the Stokvel to the member are “received by or accrued to” the member; the “capital or revenue” nature of the amount will be discussed briefly where amounts are “received by or accrue to” the member;
- assessing whether the expenses incurred by a Stokvel qualify for deduction in terms of the “general deduction formula”; and
- assessing whether the expenses incurred by a member of a Stokvel qualify for deduction in terms of the “general deduction formula”.

1.3 Methods, procedures and techniques

An interpretative research approach will be adopted for the research as it seeks to understand and describe (Babbie & Mouton: 2009). The approach may be described as a doctrinal research methodology. This methodology provides a systematic exposition of the rules governing a particular legal theory, in the present case the legal rules relating to whether an amount is “received by or accrued to or in favour of” and “not of a capital nature” for the purposes of being classified as gross income and the legal rules relating to “general deductions formula” in terms of the Income Tax Act. The methodology analyses the deduction between the rules, explains areas of difficulty and is based purely on documentary data (McKerchar: 2008).

The documentary data to be used for the research consist of:

- South African legislation (primarily the Income Tax Act);
- case law;
- journal articles;
- textbooks and other writings; and
- articles in the public press.

The research is conducted in the form of an extended argument, supported by documentary evidence. The research will adhere to the rules of statutory interpretation, as established in terms of statute and common law, will place greater evidential weight on legislation, case law that creates precedent, or which is of persuasive value (primary data) and the writings of acknowledged experts in the field. Opposing viewpoints will be discussed, and the conclusion based on credible evidence and the rigour of the arguments.

As all the documentary data is publicly available, no ethical considerations arise.

1.4 Overview of the thesis

The thesis is divided into seven chapters. Chapter 2 discusses the nature of a Stokvel. The chapter focuses on defining what a Stokvel is and outlines different types of Stokvels. An overview of the Stokvel market through analysis of the spending power,

membership size and the informal nature of the Stokvel is provided in the chapter. Lastly the chapter discusses the operation of a Stokvel and the legislative framework.

Chapter 3 discusses the gross income definition in relation to the contributed funds and other income. The discussion will be considered from the perspective of different types of a Stokvel. Chapter 4 discusses the gross income element covered in chapter 3 but from the perspective of the Stokvel member.

Chapter 5 discusses whether the expenses incurred by a Stokvel qualify for deduction in terms of the “general deduction formula”. Chapter 6 discusses the same issue as in chapter 5 but from the perspective of the member. The final chapter summarises the findings of the research and provides concluding remarks.

CHAPTER 2: THE NATURE OF A STOKVEL

2.1 Introduction

The main purpose of the research is to discuss the South African income tax implications of a Stokvel. It then becomes important to understand what a Stokvel is, before addressing the research goal. Literature notes that Stokvels have been in existence as far back as the nineteenth century, where black farmers and labourers exchanged ideas and gambled whatever resources they had at the “stock fairs” they attended (Lukhele, 1990). These “stock fairs” were a platform for farmers and labourers to socialise and pool money to purchase livestock (African Response, 2012). At these “stock fairs”, black farmers and labourers won many prizes competing against white farmers (Lukhele, 1990:4).

Lukhele (1990:4) explained that the discovery of gold in the Transvaal (now Gauteng) resulted in an influx of people (predominately males) from all over the world, including the black farmers and labourers, who brought with them the concept of a Stokvel. The influx of the mineworkers created serious accommodation problems, resulting into cramped, insanitary living conditions, which in turn resulted in many deaths from diseases such as cholera, smallpox, tuberculosis and typhoid. The mineworkers developed burial societies, a form of a Stokvel, with the purpose of meeting the high cost of funerals. Burial societies were thus particularly prominent among Stokvels with the main aim of mobilising savings for a specific purpose (Irving, 2005:12)

In the years to follow, women started arriving in the cities and towns where their husbands, who were mineworkers, resided. In those years, black mineworkers and their families lived below the poverty line, so Stokvels became a way of supplementing their income (Lukhele, 1990:5). Presumably, this led to the formation of different types of Stokvels as the wives took Stokvels into their homes and made them part of their households (Lukhele, 1990:6).

Modern day Stokvels are formed for various purposes, as will be discussed later when different types of a Stokvel are dealt with. However, the definition of a Stokvel needs to be discussed first.

2.2 Defining a Stokvel

There are various Stokvel definitions and according to Irving (2005:10), the problem in defining a Stokvel “stems in part from a genuine absence of clear boundaries in operation and functions between the different types of groups.” Calvin and Coetzee (2010:1) concur when they mention that the contention in defining Stokvels is due to a wide variety of Stokvels that exist. These contentions may be because “some Stokvels retain part of the savings to extend as credit to members at a given interest rate, while others keep the funds to be used in an investment fund or to purchase an asset which is meant to generate income for the members” (Calvin and Coetzee ,2010:1). It therefore, brings into question whether the contributed funds are “received by or accrue to or in favour of” the Stokvel.

In conducting their research on Stokvels, the African Response (2012:2) adopted a working definition of a Stokvel as “group savings schemes providing for mutual and financial well-being as well social and entertainment needs.” Calvin and Coetzee (2010:1) define a Stokvel as an “informal savings group”. In citing Verhoef (2002), Mashigo and Schoeman (2010:1) state that “a Stokvel can, in general terms, be defined as an umbrella term used to describe informal savings organisations in the African community in South Africa.”

It can be argued that these definitions are derived from a definition provided by Andrew Lukhele, the founder and president of the National Stokvel Association of South Africa. Lukhele (1990:1) defines a Stokvel as:

a type of credit union in which a group of people enter into an agreement to contribute a fixed amount of money to a common pool weekly, fortnightly or monthly. Then, depending on the rules governing a specific Stokvel, this money or a portion of it may be drawn by members either in rotation or in a time of need. This mutual financial assistance is the main purpose of Stokvels, but they also have valuable social and entertainment functions.

A common feature that is evident in the definitions of a Stokvel is an element of rotation in respect of how the funds may be used and the element of saving towards a common goal. Generally, members of the Stokvel are afforded the opportunity of receiving the contributed funds in a lump sum or a portion thereof on a rotational basis. This has led

to Stokvels being classified as rotating and savings credit associations (ROSCA), a view expressed by Verhoef (2002:2). Considering the member's opportunity of receiving the "pot" of the contributed funds on a rotational basis, it can be questioned whether those funds" would be "received by or accrue to or in favour of" the Stokvel member.

Apart from the rotation and savings elements mentioned above, another element that is noted in a Stokvel is the social and entertainment aspect that a Stokvel tends to serve, perhaps, as a secondary objective. Kibuuka (2006:18), citing Ayse (2000), states that "the ability of individuals and groups to form and operate Stokvels has often been closely associated to the availability of what is referred to as social capital". Irving (2005:3), citing Putnam (2000), states that "social capital refers to the connections among individuals – social networks and the norms of reciprocity and trustworthiness that arise from them".

Verhoef (2002) believes that the need to establish a social network of trusted friends to replace the traditional kinship network was one of the shared objectives that facilitated the creation of Stokvels among black South Africans. Social capital can thus be seen as the foundation upon which the financial mutual assistance objective is established.

The social capital and rotating and saving elements are thus the common features noted in the definition of a Stokvel. However, it can be contended that of those elements, the more important one is the rotating and saving elements, as Stokvels exist mainly to fulfil a specific financial objective.

2.3 Rotating savings and credit associations

Since Stokvels are referred to as ROSCAs, it becomes necessary to understand what a ROSCA is, for the purposes of understanding the view expressed by Verhoef (2002) that Stokvels are classified as ROSCAs.

2.3.1 What is a ROSCA?

Irving (2005:11), in citing Ardener (1964:201), mentions that a ROSCA is defined as "an association formed upon a core of participants who agree to make regular

contributions to a fund which is given, in whole or in part, to each contributor in rotation.” Kibuuka (2006:17), citing Callier (1990), defines a ROSCA:

as a group of people who know and trust each other and who agree to contribute a fixed amount at regular intervals into a fund. This fund is given in its entirety to a different member of the group at each group meeting and there is no interest to be paid. The order of rotation is determined in different ways, but mostly by negotiation, by lottery or by the credit-worthiness of the participants.

Varadharajan (2004:2) states that “this process continues until every member of the group receives the pot of money once.” Bouman (1979:253) states that:

essentially, a member of a ROSCA will lend money to other members through his or her regular monthly contributions. After having received the lump sum amount when it is his or her turn (i.e. borrow from the group), the amount is then repaid in regular or further monthly contributions. This explains the name rotating savings and credit associations.

Thus, each member in a ROSCA, and indeed in a Stokvel, will alternate between being a lender and borrower. That is, there is a mutual give-and-take involved in ROSCAs. From the above description, it is evident that the definition of a ROSCA mirrors that of a Stokvel, validating Verhoef’s (2002) view that Stokvels in South Africa are generally referred to as ROSCAs.

2.3.2 Advantages and disadvantages of a ROSCA

According to Bouman (1979), the following are some of advantages of a ROSCA:

- it offers an opportunity for members to save and the same time keep such savings fairly liquid and maximising returns;
- it facilitates the availability of a lump sum of money, which allows for higher investment to be made earlier than the accumulation of savings; and
- profits (in the form of bid amounts, for example) and other returns on accumulated contributions are distributed equally to all members.

Some of the disadvantages of a ROSCA identified by Bouman (1979) include:

- a risk of mismanagement, fraud and bankruptcy by the organizer where he or she absconds with the accumulated contributions;
- timing of the receipt of funds by a member may not necessarily coincide with the need for finance; and
- the cyclical timing also applies to savings, where a member cannot save when he has surplus funds but has to wait for the ROSCA meetings.

Adding to the advantages and disadvantages indicated above, Adams and Von Pischke (1992), as cited by Kibuuka (2006:17), identified three characteristics of ROSCA that they believe contribute to their popularity. Arguably, one of those characteristics that holds true for Stokvels is that “ROSCAs are very flexible institutions. They can be applied in diverse social circumstances, have diverse group characteristics and operate in diverse countries (both in rural and urban settings).” This holds true for different types of Stokvels, in that some Stokvels exist to cater for the low-income earning members of society in order to supplement their income while others exist for the middle- and high-income earning population, where they may seek to take advantage of investment opportunities that may arise.

2.4 Types of Stokvel

Different types of a Stokvel exist and the difference in classification depends on the functions that each serve. Although differing in their functions, which are implicitly implied in their description, the common feature that they most share is that they reflect the features of a ROSCA discussed earlier. The types of a Stokvel are discussed below.

2.4.1 Burial societies

According to Lukhele (1990:16) these “types of Stokvel were established in the latter part of the nineteenth century as the black population caught up in industrialisation faced the high costs of funerals, which play an important role in black culture.” Verhoef (2002:4) mentions that “high mortality among urban labourers resulting from unsanitary living conditions, dietary changes, and disease epidemics created an above-average demand for funeral arrangements.” Verhoef (2002:4) further states that:

in the African communities, the cost of funerals was increased by the requirement that the deceased should be buried with honour and pride (implying expensive coffins and funeral arrangements, as well as a meal for all the funeral guests) where the deceased's forefathers were buried. Funeral costs also soared as a result of the transportation costs to return the body of the deceased to often-distant ancestral lands.

According to Calvin and Coetzee (2010:4), "these societies are formed by people who know each other and have a common bond." They continue to state that these societies "also offer emotional and physical support at the time of death to members and family". Calvin and Coetzee (2010:4) further state that these societies "are not for profit and are governed and managed by members" and that "most burial societies in South Africa are contributing societies."

Lukhele (1990:17) mentions that two distinct types of burial society can be identified. In the first type he states that "a group of people enter into a loose, unwritten agreement to contribute a specified amount of money in the event that a member or anyone in his immediate family dies. This form of burial scheme is often small, and no bank accounts are opened." The contributed funds are given to the family of the deceased, which are used to cover the funeral costs. These costs may include expenses relating to purchasing a coffin, transport services, hiring tents and food. In this regard, it can be questioned whether the funds will be beneficially received by the member and whether the funeral costs may be deducted in terms of section 11(a) of the Income Tax Act.

In the second type, Lukhele (1990:18) states that "members contribute a fixed amount of money either weekly, monthly or annually. Bank accounts are opened, and formal written arrangements or a constitution is drawn up detailing how the scheme will operate and amounts that shall be paid." He further mentions that contributions can be quite high and some of the large schemes keep bank accounts with a substantial amount of money. The difference between the two schemes is that the former is collective in nature, as funds are only collected upon the actual occurrence of death, whereas the latter is contributory in nature and does not wait for death to occur, but rather is in preparation for the inevitability of death.

2.4.2 Entertainment Stokvels

According to Irving (2005:13), the social element provided by a Stokvel appears to have given birth to entertainment Stokvels, “which have as their focus generating rather than saving money.” In these types of Stokvel the recipient of the pool is responsible for hosting a gathering that other members pay to attend. Irving (2005:13) states that “an entrance fee is charged, and food and drinks are sold at a profit. Loud music is played to entertain guests and attract passers-by to the gathering.” Irving (2005:13) further states that “the host may generate considerable earnings over and above the amount raised by standard Stokvel contributions – these groups are thus distinct from ROSCAs in that the primary source of income is not savings.” The gross income implications of the resulting funds and deductibility of expenses for income tax purposes, will have to be examined.

Irving (2005:13), citing Verhoef (2001), continues to state that “in entertainment stokvels, harsh penalties may be imposed on members who fail to attend meetings and in extreme cases expulsion may result, as no-shows result in loss of income for the host and violate the norm of reciprocity on which these groups are based.”

2.4.3 Purchasing power groups or cooperative buying societies

This type of Stokvel is established to facilitate bulk buying. Lukhele (1990:25) states that “the Stokvel stresses the importance of buying only when there is enough cash.” Thus, in this type of a Stokvel, the members receive goods that are purchased using the Stokvel funds. Grocery Stokvels fall within this category, as households look to ease the pressure of spending money on groceries, especially given the increasing price of food.

In conducting their research on grocery Stokvels, The African Response (2012:11) noted that bulk purchases are “done mainly once a year as the main aim is to provide a reserve of groceries for a significant amount of time, hence items purchased tend to be non-perishables.” Furthermore, the research noted “that the majority of bulk shopping is done at the end of the year during the festive period, while other religious holidays such as Easter bring about various types of spending, from gifts to transportation.” The receipt of the purchased goods by member will need to be examined to assess the gross income implications. In addition, it can be questioned

whether the money spent on goods by Stokvel may be deductible in terms of section 11(a) of the Income Tax Act.

The African Response (2012:15) notes that the Fast-Moving Consumer Goods players are beginning to appreciate the value of Stokvels “with Massmart acknowledging the significant portion of sales associated with Stokvels.” The African Response (2012:15) further state that

Massmart acknowledges the need to look after this segment by stating that its wholesale chains such as Jumbo and Makro will ‘continue paying special attention’ to Stokvels by providing concessions such as bulk discounts, proactive collection of orders and arranging affordable transport to the Stokvel community.

Irving (2005:14) states that “while such arrangements are frequently cited in casual discussion of Stokvels, they are all but ignored in the literature, perhaps because their existence presents no particular insight into economic or social behaviour beyond the obvious.”

2.4.4 Investment syndicates or clubs

These types of Stokvel are established with the purpose of generating funds to start a business or acquiring an income-generating asset such as a block of flats or land (Lukhele, 1990; Irving, 2005). According to Verhoef (2002:5), “participation in such Stokvels has provided members with an opportunity to obtain ‘seed capital’ to finance small businesses.” Seed capital is the initial capital used when starting a business. An investment Stokvel may also invest in shares or interest-bearing instruments. Kibuuka (2006:25) states that “investment club Stokvels are most common amongst educated people in the urban areas, with more stable and higher incomes.” The gross income implications of the resulting income will need to be assessed to determine whether the Stokvel will beneficially receive the income.

Lukhele (1990:20) states that “another type of investment syndicate pools money to lend out at a profit.” Anyone (members and non-members) who needs money and meets the lending requirements of the Stokvel can borrow an amount, to be repaid with interest after a fixed period. Thus, this type of Stokvel serves as both a credit and banking facility for members (Irving, 2005, citing Burman & Lembete, 1995). Lukhele

(1990:20) further states that “the primary source of income in this type of syndicate is the interest charged on money loaned, plus fines for late payment of contributions by members, late arrival at meetings or absence from a meeting without prior apology.”

Verhoef (2002:5) explains that “in serving as a source of credit, investment Stokvels differ from ordinary Stokvels, as lending is not their most important function, but rather an additional role facilitated by the larger pool of funds.” This type of syndicate is dissolved at the end of year and the pool is divided amongst the members (Lukhele, 1990; Kibuuka, 2006).

2.5 The Stokvel market

There is a perception that Stokvels are for the “old women in poor communities” (Sanlam: Online). In addition, literature often claims that Stokvels are largely used by the poor community. However, research has shown that Stokvels are also used by the middle- and high-income earning members of society (Kibuuka, 2006; Coetzee & Calvin, 2010).

Sanlam (Online) reported that “most households with incomes above R14 000 per month in 2016 belonged to a Stokvel. The more the household earns, the higher the incidence of belonging to more than one Stokvel.” Sanlam (Online) continues to mention that “in 2017, 42% of households with an income of R40 000 and above belonged to more than one Stokvel.”

Over the years the Stokvel market has shown an increase in the membership numbers. In 1989, it was reported that the membership numbers were approximately 680 000, while in 2003 the number stood at 10.5 million (Lukhele, 1990; African Response, 2012). In 2017, Fin24 (Online) reported that the membership numbers stood at 11.5 million spread across 80 000 Stokvels.

Sanlam (Online) reports that:

most members of Stokvels are employed and economically active members of society. The majority (83%) of these members have some form of employment (formal or informal). Most members fall into living standards measures (a marketing and research tool used in South Africa to classify standard of living and disposable income) five and six (32% and 27% respectively). These saving

schemes are also attracting members with higher living standards measures, with measures eight to ten accounting for 20% of Stokvel members.

The spending power of Stokvels is just as impressive as the membership numbers. In 1989 the Stokvel market was valued at R624 million, while in 2003 the value increased to R12 billion (Lukhele, 1990; African Response, 2012). In 2017, Fin24 (Online) reported that the Stokvel market was valued at R49 billion. Given the reported spending power of the Stokvel market, an assessment of the gross income and the “general deduction formula” implications is necessary for both the member and the Stokvel.

Despite the impressive growth of Stokvels over the years, there is a perception that Stokvels are operationally informal in nature, thereby making them unattractive, from a transactional viewpoint, to the formal financial sector (Sanlam: Online). As was previously discussed, the main purpose of Stokvels is to provide “mutual finance assistance” (Lukhele, 1990:1), and coupled with the perception of Stokvels’ informality, this may translate into Stokvels essentially operating in the informal financial sector.

2.5.1 Informal financial sector

According to Callier (1990), as cited by Kibuuka (2006:8), “the term ‘informal finance’ is difficult to define. It covers a broad variety of institutions and mechanisms. The common denominator appears to be that these institutions provide finance outside of the control of state authorities.” Kibuuka (2006:8), citing Mohane, Coetzee and Grant, (2000), state that “informal financial service providers therefore literally include or refer to those suppliers who do not fall under the jurisdiction of monetary laws, taxes and any other forms of financial regulation.”

Kibuuka (2006:9), in citing Isaksson (2002), states that “attempts to explain the existence of informal finance reveal two main views...the first view is based on the argument that the informal financial sector is a reaction to policy distortions or financial repression.” This view ties in with the comments made by the former South African Reserve Bank Governor, Tito Mboweni, when he argued that “Stokvels were initiated by the disadvantaged black community’s need for survival strategies to mobilize financial resources during South Africa’s previous dispensation, in a bid to cope with

economic oppression grounded in race and class exploitation” (African Response, 2012:2; citing Mboweni, 1990).

Kibuuka (2006:9), in citing Isaksson (2002) further mentions that:

the argument put forward is that the informal sector is more efficient as it is not subject to regulation. The second view maintains that the informal sector has a comparative advantage in some market segments, especially where acquisition of information is costly for the formal sector.

There are certain advantages that make the informal financial sector attractive to participate in. Kibuuka (2006:10), in citing Schreiner (2000), Matin, Hulme and Rutherford (2002) and Genesis (2003), lists those advantages as:

- informal institutions offer a disciplined environment for saving. Once the initial decision to join a savings club has been made, withdrawal can only take place at the end of the cycle, otherwise one faces peer pressure or even sanctions should he/she pull out;
- unlike most formal institutions, informal financial institutions offer individuals a chance to save in small instalments, which particularly suits the poor;
- they are convenient and there is an absence of formalities. This implies that no forms are completed. This eliminates reliance on documentation, which in turn removes literacy constraints and reduces the waiting period for processing a transaction, as well as transaction costs. The financial services are usually provided near users’ residences or place of work and may even be available outside official working hours;
- the largest proportion of transactions takes place between parties who are well known to each other and who live or work in the same vicinity. This reduces the information asymmetry and transaction costs faced by both parties to the deal;
- the transactions are usually carried out within familiar communal networks. This eliminates the feeling of intimidation and discomfort experienced in bank branches due to unfamiliar surroundings, exposing personal problems to strangers (privacy

concerns) and the frequent use of languages in which users may not be able to fluently express themselves;

- there is reciprocity in borrowing. This serves as a kind of access to a liquidity-guaranteeing function, which is especially important to business operators. In addition, it continues to build social collateral, and this is the same as a two-directional overdraft facility;
- most transactions in the informal sector take place “free from official eyes” and since the institutions are not registered, no government taxes are payable. This creates a form of cost-cutting opportunity for the users.

Perhaps a more fitting attraction of the informal financial sector lies in the fact “that the Stokvel financial structure is Afrocentric and is grounded on collectivism. In contrast, the formal financial market is anchored on a Eurocentric foundation, a financial culture designed around the individual” (Wegelin, 2012:28).

Operation of Stokvels in the informal financial sector feeds into the perception that Stokvels are informal in nature. However, the way in which Stokvels operate may potentially challenge the informality perception.

2.5.2 Operation of a Stokvel

Irving (2005:14) explains that “depending on literacy levels, savings groups (which include Stokvels) may have a formal constitution outlining rules and procedures.” Irving (2005:14), citing Verhoef (2001) and Moodley (1995), states that “the majority appear to have such a document, and a similarly large number keep minutes of proceedings at meetings.”

The National Stokvel Association of South Africa (Online), “which exists to create an environment where Stokvel groups and members can prosper through access to valuable information, services, opportunities and products”, has drafted and published a constitution that Stokvels can use as guide to create their own constitution. In the draft document, the National Stokvel Association of South Africa (Online) commented

that the “constitution provides a set of fundamental principles according to which a Stokvel or a community-based deposit-taking organisation is governed.”

Wegelin (2012:30) states that:

some constitutions are very detailed documents drafted by people with a legal background, and others are mere basic set of rules and principles by which the stokvel operates. Amongst other things, the constitution generally covers the following:

- the purpose or objectives of the stokvel;
- membership requirements, how to become a member and basic rules to maintain membership;
- management, the defined roles of a stokvel and what is expected of each position;
- meetings, and how frequently members should meet;
- the joining fee;
- contributions – weekly or monthly, and whether contributions can fluctuate;
- how benefits and payments are done;
- a code of conduct; and
- banking or storage of funds.

Based on the comments above, the existence and application of a constitution may provide an indicator that Stokvels may have an element of formality. Wegelin (2016:30) states that “there are generally three key positions in any Stokvel, namely a chairperson, treasurer and a secretary. Depending on the size, these can be fulfilled by one person or three individuals who are elected to stand for a period of time.” The National Stokvel Association of South Africa (Online) draft constitution mentions the responsibilities of a chairperson as (as a guide) to “lead and prepare the agenda for meetings; make sure rules are followed; approve money withdrawals together with other executive member; and explore opportunities for enhancing the group’s practices.”

With regard to the responsibilities of a secretary, the document refers to “keeping an accurate record of the group’s activities, namely minutes, correspondence and a membership register; maintain communication to make sure all members are informed

of all activities of the group; have signing powers with the chairperson and treasurer.” With regard to the responsibilities of a treasurer the document lists these as “keeping accurate account of all the group’s finances and presenting copies of all the deposit slips; collecting money or deposit slips at every meeting; having signing powers with the chairperson and the secretary.” Based on the responsibilities listed above, it can be contended that these responsibilities would typically exist in a formal organisation, which may challenge the idea that all Stokvels are regarded as informal.

To further challenge the notion of informality, Wegelin (2012:30) notes that “Stokvel’s meeting agendas may discuss items relating to balance sheet, monthly contributions, missed contributions, and new membership.”

2.5.3 Legislative framework

Stokvels are not regulated as” they operate under the exemption of the Banks Act No. 94 of 1990” (Calvin & Coetzee, 2010:1). Coetzee and Calvin (2006:1) report that:

the South African Reserve Bank (SARB) started targeting stokvels in 1996, publishing a green paper to show its position on stokvels. By 2006, the SARB introduced legislation pertaining particularly to stokvels. An amendment was made to the Banks Act No. 94 of 1990 to cater for stokvels in terms of which they are seen as falling outside the definition of a commercial bank. This meant that stokvels were viewed as legal, self-governing entities, operating outside the regulations covering banks. They were, therefore, allowed to take deposits from their members only, but were not allowed to hold in excess of R9.99 million at any one time. Any stokvel exceeding this amount would be required to register as a mutual bank and would then legally fall under the Mutual Banks Amendment Act, 1994 (Act 25 of 1994).

Wheeler (2012) suggests that Stokvels can be classified as financial service co-operatives and thus be registered and governed under the Co-operative Act, 14 of 2005 (hereafter referred to as the Co-operative Act). In understanding what a financial service co-operative is, it is necessary to first understand what a co-operative is.

Section 1(1) of the Co-operative Act defines a co-operative as “an *autonomous* association of persons *united voluntarily to meet their common economic and social needs* and aspirations through a jointly owned and democratically controlled enterprise

organised and operated on co-operative principles” (emphasis added). This definition reflects what a Stokvel is and aims to do, in that Stokvels are self-governed and they exist to provide mutual financial assistance and satisfy social needs.

Section 1(1) of the Co-operative Act goes on to define a financial service co-operative, which Wheeler (2012) alluded to regarding the registration of Stokvels. A financial service co-operative is defined as “a primary co-operative whose main objective is to provide financial services to its members, or a secondary co-operative that provides financial services to a primary co-operative”. In turn, a primary co-operative is defined as a “co-operative formed by a minimum of five *natural persons* whose *object* is to provide employment or *services to its members and to facilitate community development*” (emphasis added). This description can be likened to a Stokvel, as a Stokvel is formed by individuals with financial and social objectives.

Section 2 of chapter 1 of the Co-operative Act provides nine purposes for applying the Act and in doing so implicitly indicates the benefits. One of the purposes is listed as to “enable such co-operative enterprises to register and acquire a legal status separate from their members”. This, perhaps, is relevant given the contention by Sanlam (Online) that the formal financial sector shies away from transacting with Stokvels as they are considered informal. This perception may be based on the contention that an organisation that can operate separately from its members may be seen to be more formal and easier to transact with.

Wheeler (2012:10) provides further benefits of registering as a Co-operative when she mentions that:

Co-operatives offer many of the same benefits as other corporate entities, such as limited liability and an existence which is perpetual. But co-operatives also offer benefits unique to this specific business model, such as the fact that the control of the business is kept in the hands of those who use the co-operatives and therefore conflict between investor and user interest is avoided with the co-operative model. From a tax perspective, corporates generally distribute dividends from after-tax corporate income, whereas co-operatives are generally afforded deductions for patronage refunds distributed to the members from pre-tax income.

Wheeler (2012:27) states further that:

in order to emphasise that co-operatives should be treated in the same way as companies for income tax purposes, co-operatives were specifically included in paragraph (c) of the definition of a “company” in section 1 of the Income Tax Act, as a result of Revenue Laws Amendment Act, No 20 of 2006. The definition of a “shareholder” was also amended to specifically include a member of a co-operative. Implicitly this means that the same tax benefits that are afforded to a company are thus also available to co-operatives.

2.6 Conclusion

Stokvels have been in existence as far back as the nineteenth century, when people from disadvantaged economic backgrounds clubbed money together to fulfil a specific financial objective. Throughout the years, Stokvels have evolved to a point where different types of Stokvels exist, which include burial societies, investment syndicates, entertainment Stokvels and purchasing power groups or cooperative buying societies. These different types of Stokvels are all formed for different purposes, which has led to the challenge of defining Stokvels.

Arguably, the definition that encapsulates the essence of a Stokvel is the one provided by Andrew Lukhele, the founder and president of the National Stokvel Association of South Africa. Noted in Lukhele’s definition is that a Stokvel’s main purpose is to provide mutual financial assistance and provide, as a secondary purpose, social and entertainment functions.

Although several definitions of Stokvels exist, a common thread evident in most of them is the rotating and savings elements and in all the social capital element. This rotating and savings element has led to a Stokvel being labelled as a rotating and savings credit association (ROSCA), the definition of which mirrors that of a Stokvel. In a ROSCA, and by implication in a Stokvel, each member is afforded the opportunity to act as a lender and borrower, hence the name “rotating and savings credit association”.

The Stokvel industry has grown tremendously over the years. In terms of membership numbers, the industry has grown by over 1 500% between 1989 and 2017. In terms of Rand value, the Stokvel market stood at R49 billion in 2017, as reported by Fin24 (Online) an increase of 308% from the R12 billion value reported in 2013. Despite the

impressive growth, there is a perception that Stokvels are informal in nature, making them unattractive to the formal financial sector to transact with (Sanlam: Online). This coupled with the fact that Stokvels provide mutual financial assistance, results in Stokvels operating in the informal financial sector.

Literature indicates various advantages that make Stokvels, and indeed the informal financial sector, attractive to participate in. One those of those advantages is that it concerns itself with the collective, thereby making it Afrocentric, while in contrast, the formal financial sector is more concerned with the individual, making it Eurocentric (Wegelin, 2012).

The way that Stokvels operate may potentially challenge the informality perception. Literature indicates that Stokvels are often governed by a constitution, a document which details how a Stokvel should operate. Using such a document to operate a Stokvel may challenge the informality perception. Since Stokvels are not regulated, it is suggested that a fitting legislation for Stokvels would be the Co-operative Act, since Stokvels meet the criteria of membership, ownership and control, which are principles central to the co-operative form of business.

Chapter 2 has provided an understanding of what a Stokvel is, with the main purpose of providing a base upon which the research goal will be explored. As part of addressing the first sub-goal of the research, the next chapter assesses whether the contributed funds and other income are “received by or accrue to” the Stokvel and if so, whether these amounts are of a capital nature.

CHAPTER 3: “GROSS INCOME” CONSIDERATIONS – STOKVEL PERSPECTIVE

3.1 Introduction

The previous chapter discussed the nature of Stokvels in order to provide a base upon which the gross income implications of a Stokvel will be discussed.

Gross income, as defined in section 1 of the Income Tax Act, is the starting point for determining a person’s taxable income. Gross income is defined 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; 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 ...

The elements of gross income are not defined in the Income Tax Act; therefore, case law will be referred to in order to gain an understanding. The gross income definition deals with both residents and non-residents. However, non-resident Stokvels will not be discussed in this thesis because, in terms of the definition of a “resident” in section 1 of the Income Tax Act, Stokvels would be considered resident if they are incorporated, established or formed in South Africa or if they have their place of effective management in South Africa. As amounts received by non-resident members of a Stokvel would in any event be from a source within the Republic, the discussion deals adequately with both resident and non-resident members.

The first sub-goal of the research is to assess whether the contributed funds and other income constitute “gross income” of the Stokvel. In addressing the research goal, the “received by or accrued to or in favour of” element of the gross income definition will be discussed. Where amounts are “received by or accrue to” a Stokvel, the “capital or revenue” nature of the proceeds will be discussed briefly. As amounts will be received by a Stokvel in the form of cash (for example, contributions by members and investment income such as rent, interest and dividends), the element “total amount in

cash or otherwise”, where the valuation of amounts in a form other than cash is required, need not be discussed.

3.2 Received by or accrued to

According to Stiglingh *et al* (2017:17):

the reference in the definition of ‘gross income’ in section 1 to ‘received by or accrued to’ makes it clear that the definition applies to both receipts and accruals. There must either be a receipt or an accrual and, in the absence of special provisions, when a person neither receives anything nor has anything accruing to him, no amount can be included in his gross income.

In relation to the “received by or accrued to” aspect of the gross income definition, Stack (2017a:16) states that “this aspect is mainly related to the tax year (period) in which gross income arises. In many instances, the receipt and accrual of an amount will coincide, but it is also possible to receive an amount before it accrues or *vice versa*.”

In the definition of gross income there is a disjunctive “or” between “received by” and “accrued to”. The question arises whether the Commissioner can tax both receipts and accruals. In *SIR v Silverglen Investments (Pty) Ltd*, 1969(1) SA 365(A), 30 SATC 199, it was held that an amount is included in the taxpayer’s gross income in the year in which it is received or the year in which it accrues, whichever occurs first. The taxpayer or the Commissioner does not have an election to tax an amount only on receipt or only on accrual.

The words “received by” and “accrued to” are not defined in the Income Tax Act, and thus case law will be referred to in order to gain an understanding.

3.2.1 The meaning of “received by”

One of the leading cases in providing an understanding of what the words “received by” mean is *Geldenhuys v CIR*, 1947 (3) SA 256 (C), 14 SATC 419. Stiglingh *et al* (2017:18) summarised the case:

The taxpayer was the usufructuary of a flock of sheep, which she sold with the consent of the bare dominium holders. A usufructuary is usually only entitled to the

fruits of an asset and not to the asset itself – in the case of sheep, for example, the usufructuary would be entitled to the wool once the sheep have been sheared, whereas the sheep would belong to another person, the bare dominium holder. The Commissioner included the proceeds from the sale of the sheep in the usufructuary's gross income. The court held that the words 'received by' mean received by the taxpayer on his (or her) own behalf and for his (or her) own benefit. The court therefore decided that the proceeds from the sale belonged to the bare dominium holders and that, although the taxpayer (usufructuary) had received the proceeds, it had not been received by her for her own benefit, but for the benefit of the bare dominium holders. A person cannot be subjected to tax on amounts received by him or her for the benefit of another.

The application of the *Geldenhuis* principle to a Stokvel is discussed in section 3.4 below.

In *CIR v Genn & Co (Pty) Ltd*, 1955 (3) SA 293 (A), 20 SATC 113, it was held that it is not every obtaining of physical control over money or an asset with a monetary value that constitutes a receipt for the purposes of the definition of gross income. The court stated that borrowed money is not received by the borrower within the meaning of the definition of gross income, since at the same moment that the borrower is given possession, he (or she) falls under an obligation to repay. The money is therefore not received for his (or her) own benefit.

In relation to the *Genn & Co (Pty) Ltd* case, Stiglingh *et al* (2017:18) state that "if, for instance, money is obtained and banked by someone as the agent or trustee of another, the agent has not received it as his own income." The principle in this case becomes relevant in the Stokvel situation since Stokvels generally hold funds for the members to be utilised for a specific purpose in the future. However, the application of the principle will have to take account of the different type of Stokvels, as they vary according to how they function.

Stiglingh *et al* (2017:18) state that:

it is evident from the cases that the underlying law of obligations repeatedly played a role in the courts' application of the concept of 'receipt'. If a taxpayer was entitled to an amount, it was consistently held that the physical receipt by the taxpayer constituted a 'receipt for his own benefit'. The intention of the taxpayer did not play

any role in these cases (and it would not have influenced the outcome of the decision). The courts repeatedly followed an objective approach.

3.2.1.1 Deposits

Regarding deposits in relation to the “received by” element, Streicher (2015:15) neatly summarises the situation when he states that:

the case of *Brookes Lemos Ltd v CIR*, 1947(2) SA 976 (A), 14 SATC 295, dealt with deposits received by a company from its customers. In this case the company did not hold the deposits in a trust for the customers. The deposits received were not deposited into a separate trust bank account either, but the funds were mixed with other funds to be used for the day-to-day operations of the company. The Commissioner then proceeded to include the deposit amounts in the gross income of the company on the basis that the amounts were received by the company. Deposits are normally held on behalf of customers that will eventually be paid back to such customers. The principle established in this case was that deposits received from customers that are not held in a separate trust account are properly received by the taxpayer and should therefore be included in the gross income of the taxpayer.

If the funds deposited into the Stokvel are kept in a separate bank account, then they may not have been “received by” the Stokvel.

3.2.2 The meaning of “accrued to”

One of the leading cases in defining the words “accrued to” is *Lategan v CIR*, 1926 CPD 203, 2 SATC 16. Stiglingh *et al* (2017:20) summarised the case:

Lategan was a wine farmer who sold and delivered wine in a particular year of assessment. Part of the price was received in that year, while the balance was payable in instalments after the end of that year. Lategan argued that the debt receivable in the future had not accrued to him, but the court held that he became entitled to a right to claim future receipts on the date of the sale and therefore had to include the value of the sale in his gross income in the year during which the sale took place.

Thus, the court held that the words “accrued to” means that to which “he has become entitled”, irrespective of the fact that the amount may only be due and payable in a

later year of assessment. If the principle is applied to the Stokvel funds the entitlement element will need to be addressed, considering the different type of Stokvels.

With regard to the principle established in the *Lategan* case, Stack (2017a:26) states that: “Watermeyer J restated the principle in a modified form in *Ochberg v CIR*, 1933 CPD 256, 6 SATC 1, by indicating that the taxpayer’s right to claim the future payment must be ‘unconditional’ before any such future instalment is said to have accrued.” Haupt (2016:23) further states that:

the ‘entitled to’ principle was extended in *Mooi v SIR*, 1972(1) SA 675 (A), 34 SATC 1, where it was held that accrual takes place only when the taxpayer becomes unconditionally entitled to the amount. An entitlement which is contingent on a future event does not result in an accrual until the event has occurred.

The unconditional element becomes relevant to a Stokvel given that certain restrictions may be imposed by the Stokvel’s Constitution on the contributed funds.

Stiglingh *et al* (2017:21) state that:

the subjective intention of the taxpayer is therefore not relevant for purposes of the concept of ‘accrual’. The underlying principles of the law of obligations (legal entitlement) provide the starting point for an inquiry. If a taxpayer, for example, received an amount in respect of which he was unjustly enriched (in other words he was not ‘entitled’ to it), then the amount shall not be deemed to have ‘accrued’ to such taxpayer for purposes of the ‘gross income’ definition (as was held in *ITC 1824*, 70 SATC 27).

3.2.3 “In favour of”

Amounts may not be received or accrue directly to a taxpayer but may be received or accrue for his or her own benefit or on his or her behalf. Section 7(1) of the Income Tax Act provides that:

Income shall be deemed to have accrued to a person notwithstanding that such income has been invested, accumulated or otherwise capitalised by him or that such income has not been actually paid out to him but remains due and payable to him or has been credited in account or reinvested or accumulated or capitalised or otherwise dealt with in his name or on his behalf . . .

This may apply in the case of an investment Stokvel, where interest or dividends may be reinvested by a financial institution on behalf of the Stokvel.

3.3 Capital nature versus revenue in nature

Where the Stokvel funds are “received by or accrued to” the Stokvel, the capital or revenue nature of the amount may be relevant. The definition of gross income excludes receipts and accruals of “capital nature”. Exclusion of capital receipts and accruals means that they are not included in gross income, unless a specific inclusion paragraph (as listed under the definition of gross income) requires that specific capital receipt or accrual be included in gross income (Haupt, 2016). Capital receipts may, however, be subject to normal tax in terms of the Eighth Schedule to the Income Tax Act and section 26A of the Income Tax Act.

The Income Tax Act does not define the term “capital nature” and therefore case law is referred to gain an understanding. In *CIR v Visser*, 1937 TPD 77, 8 SATC 271, clarity was provided when Maritz J stated (at 276) that:

‘Income’ is what ‘capital’ produces, or something in the nature of interest or fruit as opposed to principal or tree. This economic distinction is a useful guide in matters of income tax, but its application is very often a matter of great difficulty, for what is principal or tree in the hands of one man may be interest or fruit in the hands of another. Law books in the hands of a lawyer are a capital asset; in the hands of a bookseller they are a trade asset.

The burden of proof that an amount is “capital in nature” rests with taxpayer in terms of section 102 of the Tax Administration Act, No. 28 of 2011. This onus must be discharged on the “balance of probabilities” as opposed to “beyond a reasonable doubt” (Stack 2017b:4). Stiglingh *et al* (2017:30) further add that “the inquiry as to whether an amount is of an income or a capital nature is a question of fact, which has to be decided on the merits of each case.” Therefore, all the relevant facts and circumstances pertaining to the funds contributed to the Stokvel need to be considered in determining whether they are capital or revenue in nature.

Haupt (2016:47) states that:

the decision as to whether an amount is capital or revenue usually arises when an asset is disposed of, or a right is given up or transferred. If the asset is a revenue asset (like trading stock) the amount received on its sale is revenue. If the asset is a capital asset (like a holiday house) the amount received on its sale is capital.

Haupt's comments are in reference to the principle of fixed and floating capital that was established in *CIR v George Forest Timber Co Ltd*, 1924 AD 516; 1 SATC 20. Explaining the principle, Haupt (2016:48) states that "fixed capital is that which is acquired with the intention to keep it (either to produce income, or to produce economic utility or some other benefit for the holder). Floating capital is that which is acquired for sale or disposal." The sale of an asset that is classified as fixed capital will result in the proceeds being capital in nature, while the proceeds from selling an asset forming part of floating capital (for example, trading stock) will be revenue in nature.

Haupt (2016:47) states that "generally, the receipt of an amount which is not matched by the sale of an asset, would be of a revenue nature." In *Modderfontein B Gold Mining Co, Ltd v CIR*, 1923 AD 34, 32 SATC 202, Innes CJ stated (at 208) that "...annuality of accrual must always be an important factor in the determination of the nature of money received – though it may not be invariably be decisive." In relation to these comments Haupt (2016:47) states that "what the court meant is that if an amount is received every year, this would normally be an indication that it is income (revenue) and not capital." The principles established in these court decisions may become relevant for the Stokvel.

A variety of tests have been used by the courts to determine the capital or revenue nature of an amount. Some tests are objective and include nature of receipts; nature of the asset sold; reason for the receipt; or the legal nature of the transaction (Stack 2017b). Some tests are subjective and include the intention test, which according to SARS (2018), is considered important in the determination of the whether receipts from the sale of an asset is capital or revenue in nature. The intention of a Stokvel, may be captured in its founding documents, if they exist.

In relation to a change of intention, Streicher (2015:21) states that:

the intention of a taxpayer is subjective in nature and could therefore change as a result of a change in circumstances or simply because the taxpayer changed his

(her) mind. This change of intention is a change in the nature of the asset held for normal income tax purposes. This principle was illustrated in *CIR v Richmond Estates (Pty)*, 1956 (1), SA 602 (A), where assets changed from trading stock to fixed capital through a change of the taxpayer's intention.

Streicher (2015:21) continues to state that:

a change in intention of a taxpayer can therefore result in the reclassification of an asset previously held as capital to trading stock and the profit on the disposal of the asset will therefore not be subject to capital gains tax but will meet the definition of gross income in section 1 of the Income Tax Act and the receipt will be included in the gross income of the taxpayer.

This becomes relevant in the context of an investment Stokvel, given that it may acquire an income-producing asset. Should the investment Stokvel later dispose of the asset, then the intention element may be relevant.

Regarding whether an amount can neither be income nor capital in nature, Stiglingh *et al* (2017:30) state that:

all receipts and accruals must be categorised as being either of a capital or of an income nature. In *Pyott Ltd v CIR*, 1945 AD 128, 13 SATC 121 Davis AJA refused to accept the principle of an amount that was both 'non-capital' and 'non-income'. He described it as a 'half-way house' of which he had no knowledge.

Stiglingh *et al* (2017:30) further state that "a single receipt may, however, be apportioned between its capital and income elements (as was referred to in *Tuck v CIR*, 1988 (3) SA 819 (A), 50 SATC 98)." Therefore, amounts received by or accruing to a Stokvel will have to be classified as either "capital or revenue" in nature. In certain circumstances, the funds may also need to be apportioned between capital and revenue.

The next section applies the principles explained above to the different types of Stokvel.

3.4 Application of case law principles to a Stokvel

In this section, the “gross income” elements discussed above will be applied to a Stokvel from the perspective of the different types of Stokvel organisations. Since a Stokvel is formed to provide a financial benefit to its members (Lukhele, 1990), it can be argued that a Stokvel (sometimes referred to as a society) is a “company” for income tax purposes and thus may be subject to income tax. It is pertinent to note that although paragraph (d) of the company definition refers to an “association” and a Stokvel is sometimes referred to as a “society”, the two words carry a similar meaning.

3.4.1 Burial societies

In chapter 2, two different types of burial societies were discussed – collection and contributing societies. Each society will be discussed separately.

3.4.1.1 Collection society

In the first type, which Bester, Chamberlain, Short and Walker (2005:15) have labelled a collection society, members of the society contribute funds only when the death of a member, or a member’s relative, has occurred. Usually no bank account is kept for this type of society and they are established through a loose, unwritten agreement (Lukhele, 1990). Bester *et al* (2005:15) state that “collection societies seem to be less organised, as contributions are voluntary, and it is therefore not predictable how much will be collected.”

Essentially this type of society receives the contributions only to forward the funds to the affected member or member’s beneficiary. The funds are not received by the society on its own behalf and for its own benefit (the *Geldenhuis* principle) but are simply forwarded to the beneficiaries. Nothing accrues to the society as contributions are paid in by the members only on death and forwarded to the beneficiary. The contributions are therefore not included in its gross income. The “capital versus revenue” question will not be considered since the funds will not be “received by or accrue to” the collection society.

3.4.1.2 Contributing society

In the second type of a burial society, labelled a contributing society by Bester *et al* (2005), contributions are made regularly (monthly, weekly or annually). Formal arrangements are put in place detailing the operations of the society and the amount of money that will be paid in the event of death (Lukhele, 1990).

Thomson and Posel (2002:85) state that in this type of society “funding transfers the risk from the member to the society, which means that the society must, at least to some extent, ensure that it has adequate funds to meet benefits that may become payable from time to time.” Bester *et al* (2005:13) state that “burial societies do not offer insurance, but rather a form of cash flow management or risk pooling service. All of these support services are, however, offered in return for a premium and are therefore considered to be financial services.” A contributing society, therefore, keeps funds in a communal pot, which the member can only access when death occurs.

Before addressing the “received by or accrued to” implications, it is necessary to consider the City Press (Online) comments regarding burial societies. City Press (Online) states that:

even though burial societies are not normally registered with any legal or formal regulatory body, they still have to operate under common law. The societies do not intend to make a profit and therefore fall under the law of a voluntary association, which deals with non-profit organisations.

From an income tax viewpoint, considering these comments would potentially mean that if a burial society is classified as a non-profit organisation or rather a public benefit organisation as referred to in the Income Tax Act, the receipts and accruals would be exempt from income tax in terms of section 10(1)(cN) of the Income Tax Act.

In terms of section 10(1)(cN) the receipts and accruals of any public benefit organisation approved by the Commissioner in terms of section 30(3) are exempt to the extent that the receipts and accruals are not from business undertakings or trading activities or the receipts and accruals are from certain integral, occasional, or approved business or trading activities. Haupt (2016:790) states that “not all non-profit organisations qualify for the section 10(1)(cN) exemption. Section 10(1)(cN) read with

section 30 and the Ninth Schedule to the Income Tax Act sets out those institutions which qualify for exemption.”

The definition of a public benefit organisation in section 30(1)(c) of the Income Tax Act states that “such activity (a public benefit activity) carried by that organisation must be for the benefit of, or is widely accessible to, the general public at large, including any sector thereof (other than small or exclusive groups).” According to Bester *et al* (2005:14), “burial societies are generally formed by people who know each other, such as family or friends”, suggesting that the society is for a select few persons. Therefore, it can be argued that a burial society caters for an exclusive or small group of members and not the public at large. This means that the society will not be regarded as a public benefit organisation from an income tax viewpoint and the society’s accruals and receipts will not qualify for an income tax exemption.

With regard to the “received by” element of the definition of “gross income”, since the Stokvel burial society has the responsibility to ensure that enough funds are available to pay out benefits (Thomson & Posel, 2002), it can be argued that it may seek investment opportunities to maximise the contributed funds to hedge itself against the risk of insufficient funds. In doing so the society would have used the contributed funds as its own funds. The contributions and any investment income would be received on its own behalf and for its own benefit (the *Geldenhuis* case).

The contributions (and any investment income) will “accrue to” the society. The society requires members to make monthly, weekly or annual contributions and as such, contracts are entered into by the members with the society (Bester *et al*, 2005, Lukhele, 1990). These contracts implicitly put the contributing society in a position where it is “unconditionally entitled” to the contributions, as the society has a right to claim the contributions. The entitlement to the contributions is not contingent upon a specific event, in that the contributions are not collected after death, as compared to a collecting society.

The facts of *ITC 707* (1950) 17 SATC 224 (C) can be used to discuss the “capital nature” implications. In *ITC 707* the taxpayer carried on the business of an undertaker and also conducted what was known as a prepaid funerals scheme. During the year of assessment under review, instalments to an amount of £225 were received by the

appellant from contributors under the scheme, funerals to a cost of £100 were provided and refunds to an amount of £20 were made by the appellant to contributors. The difference between the gross amount so received by the appellant and the cost of the funerals provided together with the amounts refunded, viz. £105, was included by the Commissioner for Inland Revenue in his determination of the taxable income of the appellant for the year of assessment. On appeal, it was held that the amounts received by the taxpayer constituted receipts of a business venture consisting of the receiving of payments in advance for a funeral to be supplied at a later date, and as such constituted a revenue and not a capital accrual.

In reaching the conclusion that the contributed monies were revenue in nature, Herbstein, Judge-President stated (at 225) that:

It is correct that there always existed in respect of the money so collected for these prepaid funerals a contingent liability in respect of the funerals which had to be provided, but the accounts which the appellant has submitted show that the cost of funerals provided in any particular year were set off against the particular collections of that year. If the cost of the funerals was an ordinary expense of the business and not a loss of capital, then it is impossible to hold that the income was not ordinary revenue.

A Stokvel contributing society essentially conducts a prepaid funeral scheme in the form of providing funds to the claimant to defray funeral expenses, rather than providing a funeral service as was the case in *ITC 707*, but the principle will still apply.

If the society has the right to invest the funds collected in the form of contributions, it could be further argued that it is carrying on an operation of business in a scheme for profitmaking (*CIR v Pick 'n Pay Employee Share Purchase Trust*, 1992 (4) SA 39 (A), 54 SATC 271; *C:SARS v Capstone 556 (Pty Ltd*, 2016 (4) SA 341 (SCA)) and therefore the contributions will be of a revenue nature and included in its gross income.

3.4.2 Entertainment Stokvel

In an entertainment Stokvel each member will receive the pool of funds when he or she hosts the entertainment event. Lukhele (1990:9) states that:

members each bring a stipulated sum of money ranging from R100 to R1000, at an agreed interval and hand it to the host or hostess. They then buy food and drinks at inflated prices. If there are nine members, and the amount stipulated is R100, the host or hostess will have R900 in his or her pocket at the end of the evening, as well as a percentage of the profits on the food and drink. The next week, however, on the appointed day it will be his turn to show up with R100 spending money.

The contributions are therefore made on the day the entertainment event occurs and given to the member hosting the event. Therefore, in an entertainment Stokvel, the host or hostess is charged with the responsibility of organising the event. The Stokvel thus provides a platform where members decide who will host the event and the contributions to be made. The Stokvel, therefore, does not invest any effort in organising the social event and it can be concluded that the Stokvel will not beneficially receive the contributed funds.

The legal entitlement to the funds needs to be examined to determine whether the funds would “accrue to” the Stokvel. Williams (2009:90) states that “an amount ‘accrues to’ the taxpayer as soon as the latter becomes entitled to it – in other words, when the *taxpayer acquires a legal right to that amount*” (emphasis added). In defining a legal right, Singh and Badgayan (2015:179) state that:

Salmond defines a legal right as an interest recognised and protected by a rule of justice. The word ‘interest’ implies any interest, respect for which is a duty and disregard of which is wrong. This definition contains two essential elements, legal recognition and legal protection. Both these elements should simultaneously and concurrently be present in an interest for its transformation as a legal right.

Singh and Badgayan (2015:180) further mention that a legal right can be analysed by splitting it into five elements, one of those elements being “the owner or the subject of the right”. The element is explained “as a person in whom the right is vested may be called the owner or the subject of a right. He (she) is the person entitled or the person of inherence.”

The Stokvel clearly has no legal right to the funds as it merely collects the funds to forward them to the host or hostess. The Constitution of the Stokvel provides the basis for the contributions and specifies the use to which the contributions must be put.

Therefore, the Stokvel will not be entitled to the funds and the funds will not “accrue to” the Stokvel.

The “capital versus revenue” question will not be considered since the funds will not be “received by or accrue to” the Stokvel.

3.4.3 Purchasing power group or cooperative buying society

Through the collection of the contributions, this type of Stokvel facilitates bulk purchases, typically at the end of the year or during certain holidays such as Easter (Irving, 2005; Lukhele, 1990). Essentially the members receive from the Stokvel what has been agreed to be purchased with the contributed funds, which may include, for example, grocery items, furniture, etc.

In *Geldenhuys Steyn J* said (at 430) that:

both “income” and “taxable income” are in their respective definitions linked up with the definition of “gross income” and it seems to be clear that in the definition of “gross income” the words “received by or accrued to or in favour of any person” relate to the taxpayer, and the words “received by” must mean “received by the taxpayer on his own behalf for his own benefit”.

In addition, the principle of the physical control over money was expressed in the *Genn & Co (Pty) Ltd* case, where Schreiner JA said (at 301) that:

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.

The Stokvel essentially buys goods on behalf of members with the funds contributed by the members. Therefore, the Stokvel does not receive the contributed funds on its own behalf and for its own benefit and essentially it is instructed by the Constitution of the Stokvel to purchase goods for members using the money. On that basis it can therefore be contended that the funds contributed will not be “received by” the Stokvel.

Considering whether the funds would “accrue to” the Stokvel, the argument put forward under the entertainment Stokvel can be referred to. The argument considered

Williams' (2009:90) comments when he states that "an amount 'accrues to' the taxpayer as soon as the latter becomes entitled to it – in other words, when the *taxpayer acquires a legal right to that amount*" (emphasis added). The Stokvel has no legal right to the funds and simply holds the funds for its members. Thus, it is not the "owner" of the funds. The Constitution provides the basis for the contributions and specifies the use to which the contributions must be put. Therefore, the contributed funds would not "accrue to" the Stokvel.

The "capital versus revenue" question will not be relevant, since the funds will not be "received by or accrue to" the Stokvel.

3.4.4 Investment Stokvel

The aim of an investment Stokvel is to use the contributions from members to acquire an income-producing asset or provide funding to start a business (Lukhele, 1990; Irving, 2005; Verhoef, 2002). Verhoef (2002:5) states that

the pool of savings is not paid out to members at the end of the meeting. Rather, the proceeds are usually saved (banked) with a common goal of carrying out capital projects, purchasing an expensive large commodity, or investing in a business venture, property, or equity.

The purchased asset, therefore, remains in the Stokvel for the purpose of producing income, and it is only the income from the asset that is either distributed to the members or retained within the Stokvel for other purposes (Irving, 2005).

An investment Stokvel operates an organisation where contributed funds are used to acquire an income-producing asset or accumulate enough funds to acquire a business with the seed capital. In Spotongmag (Online) a feature was done on a property Stokvel investment club. In describing how the Stokvel works, Spotongmag (Online) states that:

phase 1 is a pool account where members contribute R2100 monthly. There is a monthly deduction of R100 from this amount for administration and maintenance such as office costs and legal fees when purchasing franchises, properties and land. As soon as phase 1 members reach the targeted goal, a property/franchise

will be purchased to generate a stable source of income. The profit that will be generated from this asset will be shared equally amongst the members annually.

Therefore, considering the above, the contributed funds will be “received by” the Stokvel on its own behalf and for its own benefit.

In describing what happens when a member of a property Stokvel investment club loses his or her job, Spotongmag (Online) states that:

you will be given three months to sort out your finances. After this period, you will be required to pay your monthly contribution for all of your missed months. If you fail to catch up on your contributions after the three month period, you will be refunded 30% of your initial contribution and 70% will remain with the Stokvel.

On for how long members should contribute, Spotongmag (Online) states that “members are required to contribute for two years.” Based on this, it can be argued that the member has an obligation to contribute and the Stokvel has the right to the contributions. Therefore, the Stokvel has a legal entitlement to the contributions, which means that the contributions will “accrue to” the Stokvel.

With reference to the “tree” and “fruit” analogy from the *Visser* case, the contributed funds (and the asset acquired with the contributions) will be regarded as the “tree” and the resulting income from the asset or the business acquired with the seed capital will be the “fruit”. Therefore, the contributed funds that are paid in the form of cash will be “capital in nature”.

The resulting income from the use of the Stokvel’s asset or from the business acquired with the seed capital, will be “received by” the Stokvel, as the Stokvel will physically receive the income on its own behalf and for its own benefit. The income will also “accrue to” the Stokvel, as it can be contended that the Stokvel will have legal entitlement to the income, through potential contracts that may arise in respect of the income-producing asset or the business acquired with the seed capital.

The capital versus revenue argument will be relevant, depending on the nature of the income-producing asset in which the Stokvel invests. If the Stokvel provides seed capital for a start-up business, the share of the profits will be revenue in nature as the seed capital is the “tree” that produces “fruit” (the *Visser* case) in the form of a share

of the profits. If the Stokvel invests in rent-bearing property, the rental and rental related income such as a lease premium or the right to leasehold improvements, will likewise be of a revenue nature. However, should the property be disposed of, two situations could arise. If the Stokvel claimed a capital allowance on the property (for example, in terms of section 13, 13quin or 13sex – a manufacturing, residential or commercial building, respectively) – and subsequently sells the property, a recoupment in terms of section 8(4) may arise, which is included in its taxable income. The sale of the property itself would be of a capital nature (disposal of the income-producing asset) and would give rise to a capital gain or loss in terms of the Eighth Schedule to the Income Tax Act.

In the case of an investment in financial instruments, the interest or dividends would be revenue in nature (section 24J or paragraph (k) of “gross income”, while section 10(1)(k) would exempt the dividends under most circumstances). The Stokvel could, however, either invest in the financial instruments or act as a dealer. In the first case, the disposal of the instrument would be capital in nature (disposal of the “tree”) and subject to capital gains tax. In the second case, as the instrument will be held as trading stock. Stiglingh *et al* (2019:475) state that “a share-dealing company will include the proceeds of the shares it disposes of in its gross income and claim the cost of the shares it acquires as a deduction...”. The disposal will therefore be revenue in nature, unless the financial instrument is an equity share that has been held for at least three years, in which case the proceeds will be capital in nature (section 9C of the Income Tax Act).

Some investment Stokvels use the contributed funds to issue credit to members and non-members, provided that the Stokvel’s lending requirements are met (Lukhele, 1990, Irving, 2005). The Stokvel, thus, generates income in the form of interest. The interest income will be “received by” the Stokvel on its own behalf and for its own benefit. The interest income will also “accrue” to the Stokvel, as the contracts entered into with the loan recipients provide the Stokvel with a legal entitlement to interest income and the Stokvel becomes “unconditionally entitled” to the income. Therefore, whether the interest income is physically received by the Stokvel or reinvested (section 7(1) of the Income Tax Act), the interest income will be included in the Stokvel’s gross income.

Section 24J may apply to the loan offered by the Stokvel. Regarding section 24J, Haupt (2016:485) states that “where interest is incurred or accrues over a period of more than a year, or where the rate of interest is not constant, section 24J sets out how much of the interest income and expenditure must be brought into account each year.” When the Stokvel issues a loan to members or non-members, the term of the loan or whether the interest rate is constant or not needs to be determined for the purpose for the application of section 24J.

Haupt (2016:487) states that “section 24J spreads the total interest on an instrument over the period (term) of the instrument.” Haupt (2016:489) further states that “section 24J(3) provides that the interest amount determined in terms of section 24J (on an “income instrument”) must be included in gross income of the holder (the lender) whether it is of a capital or a revenue nature.” The loan offered by the Stokvel falls within the definition of an “instrument” in terms of section 24J (1), which includes “any form of interest-bearing arrangement or any debt”. The Stokvel will not be taxed on the actual interest income that is received each year, but rather on the accrued interest calculated in terms of section 24J. The interest income to be taxed during a year of assessment may or may not be equal to the actual interest received, depending on circumstances (Haupt 2016:489).

3.5 Conclusion

Chapter 3 discussed the elements of the gross income definition from the perspective of the different Stokvels. Case law was referred to in gaining an understanding of these elements. In cases where it was concluded that the Stokvel funds would be “received by or accrued to” the Stokvel, the “capital or revenue” nature of the amount was briefly discussed.

Applying relevant case law to a burial society structured simply as a collection society, it was concluded that the society will not beneficially receive the contributed funds. It was contended that the society will receive the funds as an agent, with the purpose of forwarding them to the member. The funds would not “accrue to” the society as it will not be “unconditionally entitled” to the collected funds.

Concerning a burial society structured as a contributing society, it was concluded that the society will beneficially receive the contributed funds. The contention was based

on the premise that since the society bears the financial risk, it may seek investment opportunities to mitigate that risk. In doing so it would use the funds as its own and thus receive the contributions on its own behalf and for its own benefit. Furthermore, it was concluded that the funds will “accrue to” the society. The entitlement to the contributions is not contingent upon a specific event in that the contributions are not collected after death, as compared to a collecting society. Using the facts of *ITC 707*, it was concluded that the contributions are not of a capital nature. In *ITC 707* it was held that the amounts received by the taxpayer constituted receipts of a business venture consisting of the receiving of payments in advance for a funeral to be supplied at a later date, and as such constituted a revenue and not a capital accrual.

An entertainment Stokvel will not beneficially receive the contributed funds, as it was contended that the Stokvel merely collects the funds to forward them to the member hosting the event. Furthermore, the funds will not “accrue to” the Stokvel as it was concluded that it has no legal entitlement to the funds. A purchasing power group or cooperative buying society will not beneficially receive the contributed funds. The contributed funds received by the Stokvel from the members are simply used to purchase supplies for the members and are therefore not beneficially “received by” the Stokvel. Furthermore, the funds will not “accrue to” the Stokvel as the Stokvel has no legal entitlement to the funds.

Concerning the investment Stokvel, the contributed funds will be “received by” the Stokvel on its own behalf and for its own benefit and used to generate investment income. The contributed funds will “accrue to” the Stokvel, as it was shown that the Stokvel will have a legal entitlement to the funds. The contributions will be considered as “capital in nature”, as they represent the amount that will be invested in order to earn income. The income to be derived from the income-producing asset or the business acquired with the seed capital will, however, be “received by” the Stokvel and will also “accrue to” it. However, the income will not be regarded as “capital in nature” as it represents the “fruit” that flows from the “tree”, the “tree” being the asset, or the business acquired with the seed capital.

Since some investment Stokvels provide loan facilities to members and non-members, it was contended that the interest income will be “received by” the Stokvel on its own behalf and for its own benefit. The interest income will also “accrue” to the Stokvel, as

it was contended that the Stokvel has a legal entitlement to the interest income and it is also “unconditionally entitled” to the income. The interest income may be subject to section 24J of the Income Tax Act, which spreads the total interest amount over the term of the loan.

Chapter 4 discusses the elements of the gross income definition from the Stokvel member’s perspective.

CHAPTER 4: “GROSS INCOME” CONSIDERATIONS – STOKVEL MEMBER’S PERSPECTIVE

4.1 Introduction

The previous chapter discussed the definition of “gross income” from the Stokvel’s perspective. Chapter 4 continues the discussion from the Stokvel member’s perspective.

In chapter 3 principles established in case law were used to understand the elements of the gross income definition, as those elements are not defined in the Income Tax Act. In chapter 4 the same case law is used to understand the application of these elements to members of the various Stokvels.

The definition of gross income refers to both residents and non-residents. However, chapter 4 will not consider the discussion from a non-resident perspective, as members of Stokvels in South Africa are all likely to be “residents” as defined in section 1 of the Income Tax Act. Foreign nationals who are members of a Stokvel would need to have their place of residence in South Africa and would most likely be “ordinarily resident” in South Africa. Furthermore, any amount received by or accruing to a member would be from a source within South Africa, and therefore subject to the Income Tax Act.

4.2 Application of case law principles to the members of a Stokvel

4.2.1 Burial Society

In chapter 2, two different types of burial societies were discussed – collection and contributing societies. The gross income implications of the amounts received by the members from each society will be discussed separately.

4.2.1.1 Collecting society

The members of a collecting society only contribute funds when the death of a member, or of a member’s relative, has occurred (Lukhele, 1990). Bester, *et al* (2005:16) state that in a collection society “people know each other and form a society, which collects an unspecified amount (i.e. contributions may vary amongst members) from each member on the death of a member.” In a collection society “no pool of funds

is built up” (Bester, *et al*, 2005:16). In essence the member does not contribute over time in order to hedge him/herself against high funeral costs, but receives the funds that are collected upon death, as a result of belonging to the society.

The member or beneficiary will only receive the funds after death is reported to the society. The funds will be used by the member or beneficiary to pay for the funeral costs and therefore the member or beneficiary will receive the funds on his or her own behalf and for his or her own benefit. However, as the member receives contributions that he or she has paid, or will pay, in respect of other members, the amount simply represents a return of capital. With respect to the “accrued to” element Stiglingh *et al* (2020:42) state that “ in other words, at the time that a taxpayer obtains a vested right to a future payment, the amount accrues to the taxpayer.” The member does not have a vested right to the future payment of the funds, since there is no build-up of funds, and the funds are paid in cash on the day of death. Therefore, the funds will not “accrue to” the member.

The funds received by the member after death is reported, may be regarded as a donation. Section 55(1) of the Income Tax Act defines a donation as “any gratuitous disposal of property including any waiver of renunciation of a right.” Stiglingh *et al* (2019:931) state that “for a disposal to be gratuitous, it needs to be for no consideration or free.” In a collecting burial society, the member does not receive the funds for no consideration, as he or she has, or will, be making contributions to other members. The contributions received by a member on the death of a family member does not, therefore, constitute a donation.

As the contributions are merely a refund of the member’s own contributions and will not be included in “gross income”, no discussion is required relating to the capital or revenue nature of the amount received.

4.2.1.2 Contributing society

In a contributing society, Lukhele (1990:18) states that “members contribute a fixed amount of money either weekly, monthly or annually. Bank accounts are opened, and formal written arrangements or a constitution is drawn up detailing how the scheme will operate and amounts that shall be paid.” The member only accesses the pool of

funds after death occurs (Bester, *et al*, 2005:16). Therefore, in a contributing society a pool of funds is built up.

The funds will be used by the member or beneficiary to cover funeral costs. It can be contended that member or beneficiary will beneficially receive the funds on his or her own behalf and for his or her own benefit. Since the member or his/her beneficiary can only access the funds when death occurs, the member will not be “unconditionally entitled” to the funds before the death occurs and the funds will therefore not “accrue to” the member or beneficiary.

A member joins the society to hedge him/herself against high funeral costs (Lukhele, 1990; Verhoef, 2001). Thomson and Posel (2002:88), citing Verhoef (2001), state that “the high costs of funerals resulted in membership of multiple societies to secure sufficient coverage on death.” In effect the member is insuring him/herself against the high funeral costs, thereby taking out a funeral insurance cover. Old Mutual (Online) states that:

funeral insurance is taken out to provide for a specific event: your own funeral or that of a loved one. Generally funeral policies pay out a lump sum quite quickly, often within 48 hours of receiving a valid claim, to a person or people that you nominate. This amount can then be used to transport family to the funeral, or the deceased to the place of burial. You can also use this money to pay for things like the funeral tent, catering for attendees, airtime so you can arrange the event, plus the casket, flowers and tombstone.

It can be argued that a contributing society provides a form of a funeral insurance to the members, even though the burial contributing society may not be regulated. FA News (Online) states that burial societies and Stokvels are exempt from “certain conditions of the Financial Advisory and Intermediary Services Act. Burial Societies and Stokvels may now render financial services to or on behalf of member without having to register as authorised financial advisors.”

The payment of the contributions by the member could be regarded as a premium paid in relation to a funeral policy – in other words by paying the contributions, the member insures himself or herself against the future payment of funeral expenses on the death of a beneficiary. The member is therefore trying to ensure that enough income will be

available to defray funeral expenses. If the contributions received are likened to a form of insurance claim, then the proceeds received by the member are likely to be capital in nature. But even if they are included in “gross income”, they will be exempt in terms section 10(1)(gl) of the Income Tax Act. Section 10(1)(gl) of the Income Tax Act exempts:

any amount received or accrued in respect of a policy of insurance relating to death...of any person who is insured in terms of that policy of insurance, including the policyholder...to extent to which the benefits in terms of that policy are paid as a result of death...

Exemption of the proceeds implies that there will be no income tax consequences.

4.2.2 Entertainment Stokvel

A member of an entertainment Stokvel receives the funds on the day he or she hosts the entertainment event. The member does not contribute on the day of the event but will contribute at the next event hosted by another member. Drinks and food are sold at the event and the member stands to receive an income from the sale (Lukhele, 1990). To support this view Irving (2005:13) states that “the host may generate considerable earnings over and above the amount raised by the standard Stokvel contributions.”

The members who pay the contributions are essentially paying for the entertainment to be provided by the hosting member. In other words, the hosting member is charging for the provision of entertainment. The hosting member also generates income from the sale of food and drinks. Therefore, the hosting member will receive the contributions on his or her own behalf and for his or her own benefit. The same conclusion will apply to the income generated from the sale of food and drinks. Since the contributed funds are only received on the day the event occurs, no funds would “accrue to” the member before the event occurs. The proceeds from the sale of drinks and foods will not “accrue to” the member either, as the amounts are paid in cash on the day of the event.

Since the hosting member receives the contributions for the provision of entertainment and the income from the sale of food and drinks (a scheme for profitmaking in terms

of the *Pick 'n Pay Employee Share Purchase Trust* decision), the contributions and the proceeds will therefore not be “capital in nature” but “revenue in nature” and included in gross income.

4.2.3 Purchasing power group or cooperative buying society

In this type of a Stokvel, contributions are made to the Stokvel for the purpose of taking advantage of bulk purchases. Due to the increasing price of grocery items, the Stokvel serves as an aid to alleviate the problem (Lukhele, 1990; African Response 2012). The value of the grocery items to be received by the member is equal to the cash contributions made to the Stokvel by the member. In that case there are no income tax consequences, as the taxpayer receives a refund of his or her contributions in the form of items purchased by the Stokvel.

The contributed funds may be invested by the Stokvel for the purposes of earning interest. Sowetan Live (Online) states that:

Pick n Pay, in conjunction with Absa, launched a grocery Stokvel account that allows Stokvels saving for groceries to earn interest on their savings until they spend the money at the store. In this scheme, Stokvel members deposit their savings directly into a specially designated Absa savings account, the Grocery Stokvel Account. Money deposited into this account earns an interest rate of 3.75% a year for balances over R50. Pick n Pay says this compares favourably with other types of Stokvel accounts on the market where the balance has to be R20 000 before interest can be earned.

However, in order to benefit from the interest, the money in this account can only be spent at Pick n Pay. When the time comes for the Stokvel members to spend their savings on groceries, their designated members can visit an Absa branch and place a notice of withdrawal with the bank. Absa then pays the money into a Pick n Pay account and within 24 hours the funds will be available to the representatives of the Stokvel.

In chapter 3 it was concluded that the purchasing power group or cooperative buying society will not beneficially receive the contributions, or the interest earned on the contributions, which will, therefore, not be “received by or accrue to” the Stokvel. Therefore, the interest earned on the contributions will be “received by” the member

on his or her own behalf and for his or her benefit. Furthermore, the interest income will also “accrue to” the member as he or she has a legal right to the interest.

Section 24J will not apply to the interest income in the hands of the members, as it will be earned by the Stokvel on the pool of contributed funds and not invested directly by the members. The interest income will be “revenue in nature” as it is earned from the contributions invested by the Stokvel on behalf of the member and included in the member’s gross income.

The member will qualify for an interest exemption in terms of section 10(1)(i) of the Income Tax Act. The interest will be exempt up to R23 800 if the member has not reached the age of 65 on the last day of the year of assessment. If the member is 65 years or older or would have been 65 years had he or she lived, then R34 500 of the interest earned will be exempt.

4.2.4 Investment Stokvel

In an investment Stokvel a member does not receive the “pot” of the contributed funds, but rather a share of the income generated by the Stokvel. The share of income is generated by the contributed funds which are used by Stokvel to acquire an income-producing asset or a business with the seed capital. Therefore, the member will receive the share of the income on his or her own behalf and for his or her own benefit.

The share of income may “accrue” to the member, as the member may have a legal entitlement to the income, which is afforded by the Stokvel Constitution. The “unconditional entitlement” element may, however, not apply and amounts not received may not “accrue to” the member as that may depend on what the Constitution of the Stokvel prescribes regarding the distribution of the income. For example, the Constitution may indicate that the distribution of income may only occur once a specific return has been obtained. If that was the case, then the share of income would not “accrue to” the member as there would be a condition that needs to be satisfied before the income can “accrue to” the member. In the absence of any condition, the income would “accrue to” the member as he or she would be “unconditionally entitled” to the income, even though the income may not have been physically received.

The share of the income will be “revenue in nature”. The income is produced from the employment of capital, the capital being the contributions invested in the Stokvel. With reference to the “tree” and “fruit” analogy referred to in the *Visser* case, it can be contended that the contributions invested in the Stokvel represent the “tree” (capital) that produces the “fruit” (income).

The share of the income distributed to members will therefore be included in gross income.

4.3 Conclusion

Chapter 4 discussed the application of the gross income definition from the perspective of the Stokvel member. In chapter 3 case law was referred to in gaining understanding of the gross income elements and these principles were applied in chapter 4. In cases where it was concluded that the Stokvel funds would be “received by or accrued to” the Stokvel member, the “capital or revenue” nature of the amount was briefly discussed.

A member of a burial collecting society will beneficially receive the funds. There is no accumulation of funds, therefore the funds will not “accrue to” the member. As the member, essentially, receives the contributions he or she has paid, or will pay, in respect of other members, the amount simply represents a return of capital. A member of a burial contributing society will beneficially receive the funds on his or her own behalf and benefit. It was contended that the funds will not “accrue to” the member as the funds can only be accessed when death occurs. It was shown that the payment of the contributions by the member could be regarded as a payment of premiums in respect of a funeral policy. Therefore, if the contributions received are likened to a form of insurance then the proceeds received by the member are likely to be capital in nature, but even if they are included in “gross income”, they will be exempt in terms section 10(1)(g) of the Income Tax Act.

Since an entertainment Stokvel member receives the contributed funds from the provision of entertainment as well as the income generated from the sale of drinks and food on the day of the event, it was concluded that he or she will beneficially receive the amounts. The contributed funds and income from the sale of food and drinks will not “accrue to” the member as they are actually received by the member on the day of

the event. will also not “accrue to” the member. The contributed funds and the income from the sale of food and drinks will be “revenue in nature”, as it was contended that the hosting member receives the contributions for the provision of entertainment and the income from the sale of food and drinks in a scheme of profitmaking.

A member of a purchasing power group or cooperative buying society receives the items purchased by the Stokvel, the value of which is equal to his or her contributions made. Therefore, there will be no income tax consequences. It was shown that the Stokvel may invest the contributions on behalf of the member with the purpose of earning interest. As it was shown in chapter 3 that the Stokvel will not receive the contributions nor will they “accrue to” it, it was then contended that the member will beneficially receive the interest on contributions invested on behalf of the member. It was further shown that section 24J will not apply to the interest income. It was further concluded that interest income will be “revenue in nature” as it will be produced by the funds contributed to the Stokvel. The interest income will qualify for an interest exemption in terms of section 10(1)(i) of the Income Tax Act.

Finally, a member of an investment Stokvel will beneficially receive the share of the income from the Stokvel. The share of income may “accrue to” the member, as the Constitution may afford the member the legal entitlement to the income. However, the “unconditional entitlement” element may be called into question, as it may depend on what the Constitution states regarding the distribution of the income generated. The share of the income will be “revenue in nature” as it will be produced by the employment of capital, that capital being the contributed funds.

Chapter 5 discusses the second research goal, that being whether the expenses incurred by a Stokvel qualify for deduction in terms of the “general deduction formula”.

CHAPTER 5: DEDUCTIBILITY OF EXPENSES – STOKVEL PERSPECTIVE

5.1 Introduction

Chapters 3 and 4 discussed the “gross income” implications from the perspective of the Stokvel and the members. The third sub-goal of the research goal is to assess whether the expenses incurred by a Stokvel qualify for deduction in terms of the “general deduction formula”.

A Stokvel may incur expenditure in carrying out its operations. Section 11 of the Income Tax Act permits a taxpayer to deduct expenditure and losses against income. However, the taxpayer must be engaged in the “carrying on a trade”. The preamble to section 11 provides that “for the purpose of determining the taxable income derived by any person from *carrying on any trade*, there shall be allowed as deductions from the income of such a person so derived...” (emphasis added). It is, therefore, clear that the taxpayer must be “carrying on a trade” before any deductions may be claimed. Trade is defined in section 1 of the Income Tax Act. However, the phrase “carrying on a trade” is not defined and therefore case law is referred to in order to gain an understanding. Once it has been established that the Stokvel is carrying on a trade, the deductibility of its expenses in terms of section 11(a) and other sections must be established.

5.2 The meaning of “carrying on a trade”

The phrase “carrying on a trade” is not defined in the Income Tax Act. However, the term “trade” is defined in section 1 of the Income Tax Act and includes:

...every profession, trade, business, employment, calling, occupation or venture, including the letting of any property and the use of or grant of permission to use any patent as defined in the Patents Act or any design as defined in the Designs Act or any trademark as defined in the Trade Marks Act or any copyright as defined in the Copyright Act or any other property which is of similar nature.

In *Burgess v CIR* (1993), 55 SATC 185 it was held that “trade” should be given a wide interpretation and includes a “venture”, being a transaction in which a person risks something with the object of making a profit. Mkonza (2017:13) states that

a venture, according to the court decision, includes a transaction in which a person takes a risk with the aim of making a profit. The appellant in the case invested in shares and there was no guarantee that there would be profits. The investment therefore carried a risk of losing the capital investment and repaying the loan to the bank, together with interest.

The activities of a Stokvel may comply with the definition of “trade”. In reference to the *Burgess* case Haupt (2016:111) states that:

in giving the definition of “trade” a wide interpretation, the court implied that the term “carrying on a trade” should also be given the widest possible interpretation. It is submitted that the court took the view that any profitable activity amounted to the carrying on of a trade, even if it was a single activity.

As discussed before, the Income Tax Act requires that a taxpayer must be “carrying on a trade” for deductions and losses to be allowed against income. Stiglingh *et al* (2017:137) state that:

to fulfil this requirement, the principle features of the specific trade will have to be examined, for example:

- Is there continuity of the activities? If so, the trade may be said to be the carrying on of a trade.
- Is the long-term objective of the trade to generate profit? If so, such trade may constitute the carrying on of a trade (*ITC 1529 52 SATC 252(C)*)

Stiglingh *et al* (2017:137) further state that “continuity and the profit motive are not prerequisites, however, for the carrying on of a trade. The activities concerned should be examined as a whole in order to establish whether the taxpayer is in fact carrying on a trade (*Estate G v COT 26 SATC 168*).” The activities of the Stokvel, therefore, will have to be examined as a whole to determine whether a Stokvel is “carrying on a trade”.

Tshikororo (2014:19) states that

It is important to consider the objective and subjective tests as developed by the courts in determining what constitutes “carrying on a trade”. It must be borne in mind that there is no universal test that can be applied in determining what constitutes “carrying on a trade”. However, there may be sets of circumstances that

could indicate the existence of trading. The features that the courts may draw inference from in determining whether the taxpayer is carrying on a trade are as follows:

- (a) the intention of the taxpayer (subjective test);
- (b) the activities of the taxpayer;
- (c) continuity of the transactions;
- (d) making a profit;
- (e) the nature of the taxpayer's work or occupation;
- (f) the nature of the taxpayer's activities;
- (g) Money-lending; and
- (h) a venture.

Certain of the above features may be used in the determination of whether a Stokvel is "carrying on a trade", such as the activities of the Stokvel and the nature of these activities, the continuity of the transactions, making a profit, money lending and engaging in a venture. An important test in this regard is a profit motive.

In *ITC 1292*, 41 SATC 163, a profit motive was considered important. It was held that a prerequisite of deductibility of expenditure is that there must be a real hope, based not on fanciful expectations but on a reasonable possibility of earning a profit.

In *CIR v De Beers Holdings (Pty) Ltd*, 1986(1) SA 8(A), 47 SATC 229, however, it was indicated that the absence of a profit motive does not exclude a taxpayer from "carrying on a trade". Corbett JA said (at 254) that:

of course, the attainment of a profit is not necessarily the hallmark of a trading transaction. A trader may for commercial reasons be compelled to resell goods at a loss. Conceivably also he may elect to resell goods at a loss in order to gain some other commercial advantage for his business. The practice of putting on sale the so-called 'loss leaders' by some merchants would fall into this category; and there seems little doubt that merchandise so sold would constitute stock-in-trade and the proceeds thereof gross income.

Therefore, even if a Stokvel is not seeking to make a profit, it will not be excluded from being considered as "carrying on a trade". Where a profit motive is not present in the Stokvel's activities, the Stokvel may have to prove that it is "carrying on a trade".

5.3 General deduction formula

Sections 11 to 18A, 22 and 23 deal with deductions that may be allowed in determination of the taxpayer's taxable income. Stiglingh *et al* (2019:118) state that:

most deductions are allowed by virtue of a so-called general deduction formula comprising

- section 11(a), which sets out what may be deducted (the positive test), and
- section 23(g), which stipulates what may not be deducted (the negative test).

No deductions may be claimed in terms of the general deduction formula (and section 11 as a whole), however, if the taxpayer is not carrying on a trade.

Section 11(a) states that taxpayers "carrying on a trade" can deduct against their income expenditure and losses, actually incurred in the production of the income, provided that such expenditure and losses are not of a capital nature. Section 11(a) can therefore be divided into five elements namely, (1) expenditure and losses; (2) actually incurred; (3) during the year of assessment; (4) in the production of the income; (5) not of a capital nature. All the elements must be satisfied before a deduction is permitted under section 11(a). Therefore, if a Stokvel is "carrying on a trade" and it incurs expenditure and/or losses, it must satisfy all the elements of section 11(a) for the expenditure or losses to qualify for deduction. The elements of the section 11(a) are discussed next.

5.3.1 Expenditure and losses

In relation to the word "expenditure", Stiglingh *et al* (2019:121) state that "in *CSARS v Labat*, 74 SATC 1 the Supreme Court of Appeal held that the terms 'obligation' or 'liability' and 'expenditure' are not synonyms." Harms AP said (at 6) that:

The term 'expenditure' is not defined in the Act and since it is an ordinary English word and, unless the context indicates otherwise, this meaning must be attributed to it. Its ordinary meaning refers to the action of spending funds; disbursement or consumption; and hence the amount of money spent...Expenditure, accordingly, requires a diminution (even if only temporary) or at the very least movement of assets of the person who expends.

The word “losses” is also not defined in the Income Tax Act. In *Joffe & Co (Pty) Ltd v CIR*, 13 SATC 354, Watermeyer CJ said (at 360) that “in relation to trading operations the word is sometimes used to signify a deprivation suffered by the loser, usually an involuntary deprivation, whereas expenditure usually means a voluntary payment of money.” In *Port Elizabeth Electric Tramway Co Ltd v CIR*, 8 SATC 13, Watermeyer AJP said (at 15) that the word appeared “to mean losses of floating capital employed in the trade which produces income.” Therefore, a Stokvel’s expenditure will be considered as an expenditure if it has been paid voluntarily and will qualify as a loss if it resulted in an involuntary deprivation.

5.3.2 Actually incurred

The words “actually incurred” are not defined in the Income Tax Act and therefore the courts have been required to provide the meaning of the words. In *Port Elizabeth Electric Tramway Co Ltd*, Watermeyer AJP said (at 15) that:

the words of the statute are "actually incurred" not "necessarily incurred." The use of the word "actually" as contrasted with the word "necessarily" may widen the field of deductible expenditure. For instance, one man may conduct his business inefficiently or extravagantly, actually incurring expenses which another man does not incur; such expenses therefore are not "necessary" but they are actually incurred and therefore deductible. But expenses "actually incurred" cannot mean "actually paid." So long as the liability to pay them actually has been incurred they may be deductible. For instance, a trader may at the end of the income tax year owe money for stocks purchased in the course of the year or for services rendered to him. He has not paid such liabilities, but they are deductible.

An amount, therefore, does not have to be actually paid by the Stokvel for it to be considered as “actually incurred”, provided the Stokvel has a liability to pay it. However, that liability must be unconditional, as was held in *Edgars Stores Ltd v CIR*, 1988(3) SA 876 (A); 50 SATC 81. Corbett JA said (at 90) that:

it is clear that only expenditure (otherwise qualifying for deduction) in respect of which the taxpayer has incurred an unconditional legal obligation during the year of assessment in question may be deducted in terms of s. 11(a) from income returned for that year...if the obligation is initially incurred as a conditional one during a particular year of assessment and the condition is fulfilled only in the

following year of assessment, it is deductible only in the latter year of assessment (the other requirements of deductibility being satisfied).

5.3.3 During the year of assessment

With respect to this element, Stiglingh *et al* (2019:123) state that:

although section 11(a) does not specifically require it, the courts have held that expenditure is only deductible in the year of assessment in which it is incurred (*Concentra (Pty) Ltd v CIR*, 1942 CPD 509, 12 SATC 95). Expenditure cannot be carried forward to a subsequent year or carried back to a previous year. However, this rule is subject to the provisions of section 23H which may in certain instances allow a deduction of expenditure which was incurred in a previous year of assessment.

Therefore, the Stokvel's expenses can only be deducted in the year in which they are actually incurred. However, section 23H, which deals with pre-payments, may in certain circumstances allow a deduction of the Stokvel's expenditure incurred in the previous year of assessment.

5.3.4 In the production of the income

Stiglingh *et al* (2019:124) state that "the 'income' referred to in the phrase 'in the production of income' is income as defined in section 1(1), namely the gross income less the exempt income."

The meaning of the words was dealt in the *Port Elizabeth Electric Tramway Co Ltd* case. Stiglingh *et al* (2019:124) summarised the case:

The taxpayer concerned was a transport company. The driver of one of its cars was involved in an accident and, as a result the driver suffered injuries and eventually died. The company was compelled to pay compensation to the deceased's dependants. To determine whether the expenditure was in the production of income, two questions were asked:

1. What action gave rise to the expenditure? In this case the action of the employment of an employee as a driver gave rise to the expenditure.
2. Is the action so closely connected with (or a necessary concomitant of) the income earning activities from which the expenditure arose as to form part of

the cost of performing it? The income earning activity is the transporting of passengers. The action that gave rise to the expenditure is the employment of drivers. There is an inherent potential risk of an accident and a potential liability when driving any vehicle. The two elements are closely connected with each other.

The expenditure was considered to be closely connected with [the activity] (a necessary concomitant of the business activities) and was therefore allowed as a deduction.

Therefore, the Stokvel's expenditure must be a necessary concomitant of its activities for it to be regarded as "in the production of the income".

Stiglingh *et al* (2019:125) state that "it is not necessary that the expenditure produces income in the year that it was incurred before it is deductible (*Sub-Nigel Ltd v CIR*, 1948 (4) SA 580 (A), 15 SATC 381). The income may be earned only in a future year, but as long as the expenditure was incurred for the purpose of earning that income, it is deductible." Therefore, the Stokvel's expenditure may qualify for deduction if it is incurred to produce income, even though the income may be earned in future periods.

5.3.5 Not of a capital nature

Expenditure cannot be deducted from income if it is of capital nature. Stiglingh *et al* (2019:125) note that:

it is often difficult to distinguish between capital and non-capital or 'revenue' expenditure. Although there is a mass of judicial decisions on the subject, it is impossible to extract a universal test that will provide for all situations. One has to look at the facts of each case and the purpose of the expenditure concerned in order to ascertain whether the expenditure is on capital or revenue account.

Nonetheless, *New State Areas Ltd v CIR*, 1946 AD 610, 14 SATC 155, has provided guidance in that regard. In relation to that case Stiglingh *et al* (2019:126) state that:

the fixed v floating capital test laid down in an earlier case was used for assistance, but the main test used in the decision was, the "operation v structure" test... Floating capital (being capital that frequently changes its form from money to goods and vice versa, for example the purchase cost of stock) is income in nature. Fixed capital (being capital employed to acquire or improve property,

plant, tools, etc., which may qualify for capital allowances) is capital in nature. Expenditure incurred to perform the income-earning operations is income in nature. Expenditure incurred to establish, improve or add to the income-earning structure is capital in nature.

Stack (2017d:2) states that “in *New States Areas Ltd v CIR*, 1946 AD 610, 14 SATC 155, Watermeyer CJ provided a test which will hold good in most cases.” Watermeyer CJ said (at 163) that:

It has been pointed out before...that in a literal sense expenditure and losses do not produce income. Save in the case of the leasing or loan of capital in some form or other, income is produced by work or services or activities or operations and as a rule expenditure is attendant upon the performance of such operations sometimes necessarily, sometimes not. Expenditure may also occur in the acquisition by the taxpayer of the means of production, i.e. the property, plant, tools, etc which he uses in the performance of his income-earning operations and not only for their acquisition but for their expansion and improvement. Both these forms of expenditure can be described as expenditure in the production of the income but the former is, as a rule, current or revenue expenditure, and the latter is, as a rule, expenditure of a capital nature...The problem which arises when deductions are claimed is therefore usually whether the expenditure in question should properly be regarded as part of the cost of performing the income earning operations or as part of the cost of establishing or improving or adding to the income-earning plant and machinery...

Furthermore, Watermeyer CJ said (at 170) that:

The conclusion to be drawn from all (the) cases seems to be that the true nature of each transaction must be enquired into in order to determine whether the expenditure attached to it is capital or revenue expenditure. It's true nature is a matter of fact and the purpose of the expenditure is the important factor; if it is incurred for the purpose of acquiring a capital asset for the business it is capital expenditure, even if it is paid in annual instalments; if on the other hand, it is in truth no more than part of the cost incidental to the performance of the income-producing operations, as distinguished from the equipment of the income-producing machine, then it is revenue expenditure even if it is paid in a lump-sum.

Stack (2017d:3) neatly summarises the guidance provided by Watermeyer CJ when she states that:

In other words, the question to be asked is: Was the purpose of the expenditure in order to create or enhance or improve the taxpayer's income earning structure? If the answer is positive, then the expenditure is of a capital nature. Alternatively, the question could be posed as follows: Was the purpose of the expenditure to operate that income earning structure? If the answer is positive, then the expenditure will be of a revenue nature.

Therefore, with respect to the expenditure incurred by a Stokvel, it needs to be determined whether the expenditure relates to the income earning operations, and if so, the expenditure will be revenue in nature and thus qualify for deduction. If the expenditure relates to the income earning structure, then the expenditure will be capital in nature and thus fail to be deducted under section 11(a).

It is pertinent to note, however, that even though an expenditure may be capital in nature it does not necessarily mean that it will not be deductible. In that regard Haupt (2016:121) states that “allowances are granted in respect of certain capital expenditure in terms of specific provisions such as those contained in sections 11(e), 11(o), 12, 12B, 12C and 13.”

5.4 Application of legal principles to the Stokvel

5.4.1 Burial society

In chapter 2, two different types of burial societies were discussed – collection and contributing societies. The “carrying on a trade” consideration and deductibility of expenses will be discussed separately.

5.4.1.1 Collection society

It is necessary to consider whether a collection society is “carrying on a trade” before discussing whether any expenses may be deducted. In that regard it is necessary to examine the activities of the society. In *Estate G v COT* Beadle CJ said (at 173) that: “The sensible approach, I think, is to look at the activities concerned as a whole, and then to ask the question: Are these the sort of activities which, in commercial life, would be regarded as 'carrying on business'?”

A collection society primarily exists to provide emotional support to the members at the time of death (Lukhele 1990). Although contributions may be collected when death occurs, Bester *et al* (2005:15) state that "...contributions are voluntary, and it is therefore not predictable how much will be collected." This suggests that contributions may or may not be collected. Lukhele (1990) further mentions that usually no bank account is kept for this type of society and they are established through a loose, unwritten agreement.

It was contended in chapter 3 that this type of society essentially collects the funds to forward them to the affected member. It was further contended that the effort invested by the society to collect the funds does not result in a profit-making scheme status, as all it does is call a meeting for the collection of funds that will be forwarded to the affected member. On this basis, it can be contended that the activities carried on by the society do not constitute the carrying on of a trade. No deductions in terms of section 11(a) or any other section of the Income Tax Act would therefore be granted. Furthermore, it was established in chapter 3 that a collection society earns no "gross income" and therefore no "income" and section 23(f) would prohibit any deduction.

5.4.1.2 Contributing society

In a contributing society, members contribute money over time, and the money can only be accessed when a death claim is submitted (Lukhele, 1990). A fund is therefore built up in order to ensure that enough funds will be available when claims are submitted (Bester *et al*, 2005). Thomson and Posel (2002:84) state that "the *raison d'être* of a burial society is to provide for the cost of a funeral on the death of a member or the dependant of a member. It thus offers a vehicle for the mitigation of the risk of inadequate financial provision for funerals for which the member or his family might become responsible." Thomson and Posel (2002:85) further state that "funding transfers the risk from the member to the society, which means that the society must, at least to some extent, ensure that it has adequate funds to meet benefits that may become payable from time to time." Based on this the contributing society can be regarded as "carrying on a trade". In chapter 3 it was concluded that the contributions received by the society will be included in its gross income. This means that a contributing burial society may deduct expenses and losses, provided that the

provisions of the section 11(a) with respect to deductibility of expenses and losses are satisfied.

The claims paid by the society qualify as expenditure actually incurred. In order to deduct the claims from income in terms of section 11(a), it must be established that the claims paid were “in the production of income” and that the claims paid are “not of a capital nature”. In addressing the first question, it needs to be determined what action caused the expenditure to arise and whether that action is so closely connected to the income earning activities that it can be regarded as the cost of performing the activities (*Port Elizabeth Electric Tramway Co Ltd*).

The action that caused the expenditure to arise is the death claim submitted by a member. As the business carried on by the Stokvel is mainly receiving contributions (included in “gross income”) and paying out claims, it can be argued that the death claims are a necessary concomitant of the income earning activities, and therefore, the claims will be incurred “in the production of income”.

To determine whether the claims are “not of a capital nature”, it can be concluded that the claims paid are incurred in relation to the income-earning operations and not the income-earning structure (*New States Areas Ltd*). It was shown in chapter 3 that a contributing society essentially provides a funeral policy. A member receives the benefits associated with that policy once death has been reported. Therefore, the claims are paid with the purpose of performing the income-earning operations, the income-earning operations being the provision of a funeral policy and providing funds in terms of that policy when a claim is submitted. Therefore, the claims paid by the society will not be “of capital nature” and will thus qualify for a deduction under section 11(a).

5.4.2 Entertainment Stokvel

According to Tshikororo (2014:20), “there is no single feature that can be pointed out that constitutes the ‘carrying on of a trade’. The taxpayer’s activities will have to be examined as a whole and decides whether there are features that resemble trading or ‘carrying on a trade’.” Irving (2005:13) states that these:

ROSCA-type groups have a social element whereby the recipient of the pool is responsible for hosting a gathering that other members pay to attend...The host may generate considerable earnings over and above the amount raised by standard Stokvel contributions - these groups are thus distinct from ROSCAs in that the primary source of income is not savings.

In describing the nature of an entertainment Stokvel, Lukhele (1990:9) states that: "members each bring a stipulated sum of money ranging from R100 to R1000, at an agreed interval and hand it to the host or hostess. They then buy food and drinks at inflated prices." Based on this, an entertainment Stokvel essentially exists to collect the funds to forward them to the member hosting the event, as it was demonstrated in chapter 3. The responsibility for hosting the event rests with the hosting member. The entertainment Stokvel therefore only provides a social club platform. Therefore, the Stokvel is not "carrying on a trade". No deductions in terms of section 11(a) or any other section of the Income Tax Act would therefore be granted.

5.4.3 Purchasing power group or cooperative buying society

This type of Stokvel is established to facilitate bulk purchasing. Lukhele (1990:25) states that "the Stokvel stresses the importance of buying only when there is enough cash." The African Response (2012:11) noted that bulk purchases are "done mainly once a year as the main aim is to provide a reserve of groceries for a significant amount of time, hence items purchased tend to be non-perishables." African Response (2012:11) further noted "that the majority of bulk shopping is done at the end of the year during the festive period, while other religious holidays such as Easter bring about various types of spending, from gifts to transportation."

The Stokvel purchases goods on behalf of members and members provide the Stokvel with the powers to do so on their behalf, to obtain bulk discounts. The members are also required to make contributions in order to pay for these bulk purchases (Lukhele, 1990, Irving 2005, African Response 2012). In chapter 3 it was concluded that the contributions received by the Stokvel are not received by it within the meaning of "gross income". Furthermore, the Stokvel does not generate any form of income. No expenses are incurred by the Stokvel on its own behalf and therefore it is unnecessary to consider the application of the "general deduction formula".

5.4.4 Investment Stokvel

An investment Stokvel's objective is to use the contributions made by members to acquire an income-producing asset or provide funding to start a business (Lukhele, 1990; Irving, 2005; Verhoef, 2002). Verhoef (2002:5) states that:

the pool of savings is not paid out to members at the end of the meeting. Rather, the proceeds are usually saved (banked) with a common goal of carrying out capital projects, purchasing an expensive large commodity, or investing in a business venture, property, or equity.

From Verhoef's comments, it is clear that different types of assets may be acquired, which may include property, financial instruments and a business venture. The purchased asset, therefore, remains the property of the Stokvel for the purpose of producing income, and the income generated by that asset is either distributed to the members or retained within the Stokvel for other purposes (Irving, 2005, Lukhele, 1990).

An investment Stokvel may provide the seed capital for a business. In this case, all the Stokvel does is make capital available in order to earn a share of the profits, and therefore no deductions would be permitted. The Stokvel may acquire a property which it rents to occupants for income. The Stokvel may also acquire financial instruments on which it earns interest or dividends. Some investment Stokvels use the contributed funds to provide credit to members and non-members, provided the Stokvel's lending requirements are met (Lukhele, 1990, Irving, 2005). Therefore, the Stokvel may be running a business of money lending. In determining the deductibility of expenses, these three alternatives will be discussed separately.

5.4.4.1 Letting of property

Some investment Stokvels use the contributions made by the members to acquire a rent-producing property. Mkonza (2017:42) stated that

The letting of property with the ultimate prospect of deriving a profit can be an indication that a taxpayer is involved in the carrying on of a business of letting property. Taxpayers earning rental income can claim certain deductions only if they are carrying on the business of letting property.

It was earlier noted, when a property investment Stokvel was discussed, that it invests the contributions in a rent producing property with the purpose of earning rental income that will be shared amongst members (Spotongmag, Online). The tenants will be required to pay rent, which enables the Stokvel to generate income. Therefore, the Stokvel will be regarded as “carrying on a trade”, and deductions may be available to it.

For example, the cost of repairs and maintenance may be incurred by the Stokvel for the upkeep of the property. These expenses will be deducted under section 11(d) of the Income Tax Act, which allows a deduction from income for repairs or beetle treatment of property occupied for trade purposes or in respect of which income is receivable. In the case of the Stokvel, the trade will be the letting of property from which rental income will be received. Section 11(d) also allows a deduction for the repair of machinery, implements, utensils and other articles used for trade purposes. The Income Tax Act does not define the word “repair”. In *ITC 491 (1941) 12 SATC 77 (U)* it was held that in the ordinary sense of the word, “repairs” means replacement or renewal of something that has become defaced or worn out or worn down by use or possibly by wear and tear. Maintenance of the property let by the Stokvel could be regarded as repairs. SARS (2015) states that:

Maintenance requires keeping the asset in good working order and condition which implies that it has become defaced or worn out or worn down by use or possibly by wear-and-tear, a requirement considered by the courts that meets the broader meaning of repairs.

If the Stokvel rents out the property for residential purposes, a capital allowance of 5% on the cost of acquisition or erection of the residential unit or improvements to the unit may be available in terms of section 13sex of the Income Tax Act, if the Stokvel owns a new and unused residential unit, the unit (or improvements) is used by the Stokvel for the purposes of trade, the unit is situated in South Africa and the Stokvel owns at least five residential units in South Africa, all of which are used by the Stokvel for purposes of a trade carried on. If the Stokvel acquired part of a building without constructing the building, then the cost on which the allowance will apply to is limited to 55% of the acquisition price and 30% of the acquisition price if an improvement is acquired. A further 5% allowance may be available to the Stokvel

if the residential unit meets the definition of a low-cost residential unit as defined in section 1.

The Stokvel may rent out the acquired property for commercial purposes. A section 13quin allowance on the cost of the property may be available to the Stokvel if the Stokvel owns a new and unused building and the building (or improvements) are wholly or mainly used by the Stokvel during the year of assessment for producing income in the course of its trade. If the Stokvel acquired part of a building without constructing the building, the cost will 55% of the acquisition price of a part of the building and 30% of the acquisition price if an improvement is acquired. The Stokvel may also acquire a building used for manufacturing, in which case a section 13 allowance of 5% on the cost would be granted, subject to certain requirements.

The Stokvel may require a lessee to pay a premium for the right of use of the buildings. In *CIR v Butcher Bros (Pty) Ltd*, 1945 AD 301, 13 SATC 21 a premium was explained as a consideration in the nature of rent passing from a lessee to a lessor over and above or in lieu of the rental payment. The Stokvel may also require the lessee to effect improvements to the building. The Stokvel may qualify for a section 11(h) allowance for the lease premiums or value of the leasehold improvements included in the Stokvel's gross income. The allowance will be the difference between the amount included in the Stokvel's gross income (either the leasehold premiums or the value of the improvements) and the present value of the amount included in the Stokvel's gross income, discounted at a rate of 6%.

The Stokvel is required to distribute the income to the members, which results in an expenditure for the Stokvel. The payment of profits may be deductible under section 11(a). As the business carried on by the Stokvel is receiving rental income which is included in "gross income" and paying out the share of profits from that rental income to the members, it can be argued that the payment of the income to the members is a necessary concomitant of the income earning activities, and therefore, the claims will be "in the production of income". As the payment of the profits relates to the income earning operations, the operations being to generate rental income from the property, the expenditure will not be of a capital nature. The payment of the share of the profits, will therefore be deductible in terms of section 11(a). Other non-capital operating expenses relating to the property would also be deductible in terms of section 11(a).

5.4.4.2 Investment in financial instruments

An investment Stokvel may invest the members' contributions in interest or dividend yielding investments. In relation the "carrying on a trade" with respect to investments Stiglingh *et al* (2019:119) state that:

in spite of its wide meaning, the term "trade" does not include all activities that might produce income, for example income in the form of interest, dividends, annuities or pensions (the so-called "passive" earning of income). Interpretation Note no 33 (issue 5) explains this as the "active step" requirement and states that it means something more than watching over existing investments that are not income producing and are not intended or expected to be so. A person who accumulates his savings and invests them in interest bearing securities or shares held as assets of a capital nature does not derive the income from carrying on any trade.

If an investment Stokvel does not trade in the financial instruments, it watches over the investments. In that case there's no "active step" by the Stokvel, and thus it cannot be considered to be "carrying on a trade". Therefore, section 11(a) will not apply to the expenditure incurred by the Stokvel. The cost of the financial instrument will constitute the "base cost" of the instrument (paragraph 20 of the Eighth Schedule to the Income Tax Act) and when the instrument is sold, the amount received will constitute "proceeds" (paragraph 11). The capital gain (or loss) will be dealt with in terms of the Eighth Schedule.

If an investment Stokvel trades in financial instruments, the financial instruments will be used as trading stock and therefore it will be carrying on a trade. Stiglingh *et al* (2019:475) state that "a share-dealing company will include the proceeds of the shares it disposes of in its gross income and claim the cost of the shares it acquires as a deduction...". The Stokvel will have to "take into account, respectively as opening and closing stock, its holding of shares at the beginning of and end of its year of assessment in terms of section 22 when determining its taxable income" (Stiglingh *et al* 2019:475). The same considerations will apply to interest-bearing instruments.

Regarding the deduction of expenses incurred by a share dealer (or a dealer in other financial instruments), Stiglingh *et al* (2019:475) state that:

any expenditure incurred by it in carrying on its business of share dealing, for example bank charges, internet access charges, cost of telephone calls and technical analysis software to manage the share portfolio, will be allowed as a deduction in determining its taxable income. This expenditure will be allowable as having been incurred in the production of income in the form of the proceeds on the disposal of shares constituting trading stock. It will usually not have been incurred in the production of the exempt dividend income. If the expenditure was incurred in the production of exempt income, this expense will not be allowed as a deduction in terms of section 11(a) as it would be prohibited by section 23(f).

Therefore, the Stokvel will qualify for deduction of these expenses in its trade as a dealer in financial instruments.

5.4.4.3 Money lending

As already indicated, some Stokvels lend money to non-members with the purpose of earning interest (Lukhele, 1990). Mkonza (2017:56) states that “for a taxpayer to be carrying on a business of money-lending, it must lend at an interest rate calculated to earn a profit and must also lend to independent parties. These two factors can be persuasive in determining whether a taxpayer is carrying on a business of a money-lender.” This was confirmed in *ITC 979*, (1962) 25 SATC 44 (F). Mkonza (2017:56) revealed that the court held that:

the appellant’s intention was to embark on money-lending and that the appellant had incurred the loss in carrying on a business as a money lender. In reaching the decision, it is evident that the court considered the number of transactions concluded by the taxpayer, the interest charged by the taxpayer to the clients, the relationship of the clients with the appellant, and the security provided by clients to the appellant. The market-related interest of ten percent that was charged showed that there was an intention to yield a profit on the transaction. The granting of security by the clients to the appellant showed that there was a system or plan in place designed to help the appellant recover its loans.

On describing how an investment Stokvel uses the contributed funds to earn the interest from lending, Irving (2005:11) states that:

These groups extend their activities beyond simple savings mobilisation to obtain interest on contributions through informal lending or the investment of collective

capital in a bank account. Returns on the former are considerably higher (Coetzee and Cross (2001) report interest charges in excess of 80% p.a.), although this partly serves to compensate for the risk of default on these loans. Some groups insist that members borrow an amount to be repaid at interest from the collected pool. The latter variety means that the (investment Stokvel) serves as both a credit and banking facility for members (Burman and Lembete 1995:36).

Based on the number of transactions concluded by the Stokvel and the interest charged, including the fact that it charges above market-related interest, an investment Stokvel is “carrying on trade” of moneylending. Therefore, expenses incurred by the Stokvel may qualify for deduction under section 11(a).

In relation to the expenditure that may be incurred by a money lender, Ruppung (2014:76) states that:

expenditure such as interest, raising fees and losses on irrecoverable loans are types of expenditure that are commonly incurred by taxpayers that carry on a trade of a money-lender...It is proper, natural or reasonable to expect that taxpayers such as money-lenders will incur these types of costs. Thus, it is reasonable to regard these expenses as part of the cost of performing the trade of a money-lender. It follows that there is a sufficiently close link between these expenses and the activities that give rise to the money-lender’s interest income. It is therefore submitted that interest, raising fees and losses on irrecoverable loans are expenditure incurred in the production of the money-lender’s interest income. These types of expenditure therefore satisfy the ‘in (the) production of income’ requirement of section 11(a)...

The above-mentioned expenses will not be of a capital nature, as those expenses relate the operation of producing the interest income. Therefore, the Stokvel may deduct the above-mentioned expenses under section 11(a).

The profits from the Stokvel will be distributed to the members, which results in an expenditure for the Stokvel. The payment of profits may be deductible under section 11(a). The Stokvel carries on a business of lending money and receives interest income. The interest income is included in “gross income” and the Stokvel is required to pay out profits to the members. It can therefore be contended that the payment of the profits is a necessary concomitant of the income earning activities, and therefore,

the payment of the profits will be “in the production of income”. The payment of the profits relates to the income earning operations, the operations being to generate interest income from lending money. Therefore, the expenditure will not be of a capital nature” and will be deductible in terms of section 11(a).

5.5 Conclusion

Chapter 5 discussed the deduction of expenses from the perspective of a Stokvel. On assessment of the collection burial society’s activities, it was concluded that the society is not “carrying on a trade” and therefore no deductions will be allowed for the society. All the society does is call a meeting in the event of death for the purpose of collecting funds to forward them to the affected member. Regarding a contributing burial society, it was shown that the society is “carrying on a trade” as a funeral insurance provider, which essentially involves a policy in terms of which a member will receive funds to pay funeral expenses. It was shown that the claims submitted in the event of death by the members will qualify for deduction under section 11(a).

It was demonstrated that an entertainment Stokvel will not be regarded as “carrying on trade” and therefore no deductions will be allowed. In reaching that conclusion the activities of the Stokvel were taken into account. It was concluded that an entertainment Stokvel only provides a social club platform. Regarding a purchasing power group or cooperative buying society it was concluded that it does not generate any form of income. No expenses are incurred by the Stokvel on its own behalf and therefore it was unnecessary to consider the application of the “general deduction formula”.

The “carrying on a trade” implications and deductibility of expenses of an investment Stokvel were discussed. In that regard, it was considered that the Stokvel may invest the contributions received, for example, in a rent producing property and financial instruments, or to provide seed capital for a business. If the Stokvel operates a rental property, it would be regarded as “carrying on a trade” and capital allowances provided by sections 13, 13quin or 13sex may be available to the Stokvel, depending on the nature of the property. The Stokvel could also receive lease premiums and leasehold improvements could be made by tenants. A section 11(h) allowance may then apply.

Other operating expenses may be incurred (deductible in terms of section 11(a)) or repairs to rental property (deductible in terms of section 11(d)).

When an investment Stokvel invests the contributions in financial instruments, it may either be carrying on a trade as a dealer in financial instruments, or simply holding the financial instruments as investments, in which case it would not be “carrying on a trade”. If the latter situation applies, no deductions will be allowed for expenses incurred in respect of the financial instruments acquired as there will be no “active step” to trade on the part of the Stokvel. The purchase price paid for the financial instrument would constitute the base cost of the instrument, the amount received for the sale would constitute proceeds, and the gain or loss dealt with in terms of the capital gains tax provisions in the Eighth Schedule to the Income Tax Act.

If the former situation applies, the Stokvel will qualify for deductions, which will be incurred in the production of income and deducted under section 11(a). These expenses may include bank charges, internet access charges, cost of telephone calls and technical analysis software used to manage the investments.

Finally, some Stokvels may lend the contributions to members with the purpose of earning interest income. In that regard it was shown that the Stokvel will be “carrying on a trade” as a money lender, lending money at high interest rates to members. It was shown that the expenses incurred by the Stokvel in the process of earning the interest income will be deductible under section 11(a). These expenses may include interest, raising fees and losses on irrecoverable loans.

Chapter 6 discusses whether the expenses incurred by a Stokvel member qualify for deduction in terms of the “general deduction formula”.

CHAPTER 6: DEDUCTIBILITY OF EXPENSES – STOKVEL MEMBER

6.1 Introduction

The previous chapter discussed whether expenses incurred by the various types of Stokvel qualify for deduction in terms of the “general deduction formula”. Chapter 6 discusses the same considerations but from the perspective of the Stokvel member.

In chapter 5 principles established in case law were used to understand the “carrying on a trade” phrase and the “general deduction formula” elements. In this chapter the same case law is used and will not be discussed but will be referred to.

6.2 Application of legal principles to the members of a Stokvel

6.2.1 Burial Society

In chapter 2, two different types of burial societies were discussed – collection and contributing societies. As was established in chapter 4, the contributions received by a member of a collection burial society are not included in “gross income” and therefore no deductions will be permitted in terms of section 23(f) of the Income Tax Act, which prohibits “the deduction of expenses incurred in respect of any amounts received or accrued which do not constitute income as defined” (gross income, less exempt income).

In chapter 4 it was shown that a member of a contributing burial society is essentially insuring him/herself against high funeral costs (Bester *et al* 2005; Thomson and Posel, 2002) and the payment of the contributions could be regarded as a premium for a funeral policy – in other words by paying the contributions, the member insures himself or herself against the payment of future funeral expenses on the death of a beneficiary. It was further contended that if the contributions received are likened to a form of insurance then the proceeds received by the member are likely to be capital in nature, but even if they are included in “gross income”, they will be exempt in terms section 10(1)(g) of the Income Tax Act. The payment of the contributions will therefore not be deductible as they will be of a capital nature or prohibited by section 23(f).

6.2.2 Entertainment Stokvel

A member of an entertainment Stokvel receives the funds on the day he or she hosts the entertainment event. The member does not contribute on the day of the event but will contribute at the next event hosted by another member. Drinks and food are sold at the event and the member stands to receive an income from the sale (Lukhele, 1990; Irving, 2005). In chapter 3 it was established that the member receives contributions as a result of hosting an entertainment event. Therefore, the other members are paying for the provision of the entertainment event.

The activities of the member in relation to hosting the entertainment event are taken into account in order to determine whether a member is “carrying on a trade”. In *Estate G v COT Beadle* CJ said (at 173) that:

The sensible approach, I think, is to look at the activities concerned as a whole, and then to ask the question: Are these the sort of activities which, in commercial life, would be regarded as 'carrying on business'? The principal features of the activities which might be examined in order to determine this are their nature, their scope and magnitude, their object (whether to make a profit or not), the continuity of the activities concerned...Each case must depend on its own particular circumstances.

Irving (2005:13) mentions that a member’s activities in hosting the event may “involve the printing of invitation cards to notify individuals other than members about a Stokvel meeting.” As the member generates income from the sale of food and drinks, the member’s activities will involve the purchase of supplies that will be sold for profit. On this basis, the member will be regarded as “carrying on a trade” and thus may deduct expenses from the income in terms of section 11(a) of the Income Tax Act.

Expenses for supplies, including the purchase of food and drinks, the printing of cards, etc. may be deducted under section 11(a) of the Income Tax Act if those expenses are “in the production of income” and they are “not of a capital nature”. In addressing the first aspect, it needs to be determined as to what action caused the expenditure to arise and whether that action is so closely connected to the income earning activities that it can be regarded as the cost of performing the activities (*Port Elizabeth Electric Tramway Co Ltd*). The action that would have caused the expenditure to arise is the

hosting of the event. The member responsible for hosting the event will receive the contributions on the day of the event and the income from the sale of drinks and food. Therefore, the expenditure incurred by the member in hosting the event will be “in the production of income”. As the expenditure paid is incurred to perform the income-earning operations (*New States Areas Ltd*) of hosting the entertainment event, the expenditure incurred by the member will “not be of capital nature”. The expenditure will therefore qualify for a deduction under section 11(a).

It can be questioned whether the contribution made by the member on the day of the event will be deductible under section 11(a), and specifically whether the contribution will be “in production of income”. It was earlier contended that a member essentially pays for the provision of an entertainment event via the contribution made. On this basis, the contribution will not be in the “production of income” as it is not incurred for the purposes of carrying on a trade. Therefore, the contribution will not be deductible in terms of section 11(a).

6.2.3 Purchasing power group or cooperative buying society

In this type of a Stokvel, contributions are made with the purpose of taking advantage of bulk purchases. Due to the increasing price of grocery items, the Stokvel serves as an aid to alleviate the increasing prices (Lukhele, 1990; African Response 2012). The value of the grocery items to be received by the member is equal to the cash contributions made to the Stokvel. As the value of the grocery items is not included in the member’s gross income, section 23(f) of the Income Tax Act will prohibit “the deduction of expenses incurred in respect of any amounts received or accrued which do not constitute income as defined”. Furthermore, the contributions made for the purchase of groceries or other household items are of a domestic and private nature and prohibited in terms of section 23(b).

6.2.4 Investment Stokvel

A member of an investment Stokvel does not receive the “pot” of the contributed funds, but rather a share of the income generated by the Stokvel. The share of income is generated by the contributed funds which are used by Stokvel to acquire an income-producing asset or to provide a business with seed capital. Essentially the share of

income received by the member is investment income, as the Stokvel invests his or her contributions either in property, financial instruments or a business venture. Stiglingh *et al* (2019:119) state that:

in spite of its wide meaning, the term ‘trade’ does not include all activities that might produce income, for example income in the form of interest, dividends, annuities or pensions (the so-called “passive” earning of income). A person who accumulates his savings and invests them in interest bearing securities or shares held as assets of a capital nature does not derive the income from carrying on any trade.

The contributions to the Stokvel that were used to generate a share of the Stokvel’s income represent the member’s capital and constitute the base cost of the investment (paragraph 20 of the Eighth Schedule to the Income Tax Act) and when the capital is repaid this will constitute the proceeds (paragraph 11 of the Eighth Schedule), resulting in a zero capital gain (if refunded in full) or a capital loss (if not refunded in full).

6.3 Conclusion

Chapter 6 discussed whether expenses incurred by a Stokvel member would be deducted against the funds received from the Stokvel. The same case law principles that were referred to in chapter 5, were referred to and applied in this chapter. Regarding a member of a collection burial society, deductions will be prohibited in terms of section 23(f) of the Income Tax Act, as it was established in chapter 4 that the contributions received are not included in “gross income”. Similarly, a member of a contributing burial society will not be regarded as “carrying on a trade” with respect to the funds received from the society. The member essentially insures him/herself against high cost of funeral costs. Therefore, no deductions will be allowed for the member.

It was shown by their activities that members of an entertainment Stokvel are “carrying on a trade”. It was further shown that the expenditure (supplies, cost of cards, etc) incurred by the member hosting the event will qualify for a deduction under section 11(a) and that the contribution made on the day of the event will not be deductible under the same section. With respect to the member of a purchasing power group or cooperative buying society, no deductions will be allowed. As the value of the grocery items is not included in the member’s gross income, section 23(f) of the Income Tax

Act will prohibit “the deduction of expenses incurred in respect of any amounts received or accrued which do not constitute income as defined”.

Finally, the “carrying on a trade” implications and deductibility of expenses of an investment Stokvel member were discussed. It was concluded that the member will not be “carrying on a trade”, as there is no active step to trade on the part of the member in relation to the share of the investment income. Therefore, no deduction against the investment income will be allowed.

Chapter 7 provides a summary of findings and concluding remarks.

CHAPTER 7: CONCLUSION

7.1 Introduction

The goal of the thesis was to discuss the South African income tax implications of a Stokvel. In addressing the first and the second sub-goals of the research, the “received by or accrued to” element of the gross income definition was discussed and applied to the Stokvel and the respective member. As the words “received by or accrued to” are not defined in the Income Tax Act, case law was referred to in order to gain an understanding. Where it was concluded that the Stokvel and/or the member satisfies the “received by or accrued to” requirement, the “capital versus revenue nature” of the proceeds was briefly discussed.

The third and the fourth sub-goals of the research was to assess whether the expenses incurred by a Stokvel and the respective member qualify for deduction in terms of the “general deduction formula”. The preamble to section 11 requires that a taxpayer must be “carrying on a trade” before any deductions or losses may be allowed. Trade is defined in section 1 of the Income Tax Act, however the phrase “carrying on a trade” is not defined and therefore case law was referred to in order to gain an understanding. Case law was also referred to in understanding the elements of the “general deduction formula” as contained in section 11(a) of the Income Tax Act.

7.2 Summary of findings

7.2.1 The nature of a Stokvel

In Chapter 2 the nature of a Stokvel was discussed. Various definitions of a Stokvel were discussed and it was contended that these definitions derive their meaning from the definition provided by Andrew Lukhele, the founder and president of the National Stokvel Association of South Africa. According to Lukhele (1990:1) a Stokvel is

a type of credit union in which a group of people enter into an agreement to contribute a fixed amount of money to a common pool weekly, fortnightly or monthly. Then, depending on the rules governing a specific Stokvel, this money or a portion of it may be drawn by members either in rotation or in a time of need.

Evident from the definition of a Stokvel is an element of rotation, which has led to Stokvels being classified as ROSCAs (Verhoef, 2002). In a ROSCA each member alternates between being a lender and borrower, thereby involving a mutual give and take. Another feature of ROSCA is that it offers social capital, which according to Putnam (2000) “refers to the connections among individuals – social networks and the norms of reciprocity and trustworthiness that arise from them.”

Chapter 2 also discussed the different types of a Stokvel. Burial societies, according to Lukhele (1990) were established with the purpose of defraying high funeral costs. Two burial societies were discussed, namely contributing and collection burial societies. In the latter the funds are only contributed upon the event of death, while in the former funds are contributed over time and a member only accesses the funds when death occurs.

An entertainment Stokvel has the main objective of generating income rather than saving the funds (Irving, 2005). In this Stokvel the member who receives the contributed funds is responsible for hosting an event.

A purchasing power group or cooperative buying society was also discussed. The Stokvel primarily exists to facilitate bulk purchases and the member receives the goods that are purchased with the contributed funds.

The last type that was discussed was an investment Stokvel which is established with the aim of generating funds that can be used to purchase an income-producing asset or generate funds to provide seed capital for a business (Irving, 1990; Lukhele 1990; Verhoef 2002). An investment Stokvel may also use the contributed funds to lend them to members and even non-members who meet the Stokvel’s lending requirements, thus earning interest income.

The Stokvel market was also discussed. Literature indicated that in 2017 the Stokvel market stood at R49 billion and that 11.5 million people belonged to 80 000 Stokvels (Fin24, Online). In the chapter it was noted that Stokvels operate within the informal financial sector and that their attractiveness lies in the fact that they are Afrocentric, choosing to focus on the community rather than being Eurocentric which focuses on the individual. This fits in with the social capital element of a Stokvel. Chapter 2 revealed that the way a Stokvel operates may potentially challenge the perception of informality.

In that regard the constitution provided as a guide by the National Stokvel Association of South Africa was referred to in support of this.

Finally, chapter 2 discussed the legislative framework that may be associated with a Stokvel. Wheeler (2012) suggests that Stokvels can be classified as financial service co-operatives and thus be registered and governed under the Co-operative Act, 14 of 2005. The chapter also indicated that a Stokvel operates under the exemption of the Banks Act No. 94 of 1990, provided it does not hold deposits of more R9.99 million. However, if it does, it would have to register as a mutual bank under the Mutual Banks Amendment Act No. 25 of 1994.

7.2.2 “Gross income” considerations – Stokvel perspective

In chapter 3 the gross income considerations with respect to the funds contributed to Stokvels was discussed. Regarding a collection burial society, it was shown that the contributed funds will not be “received by or accrue to” the society as the society receives the contributed funds only to forward them to the member. Therefore, the society receives those funds as an agent. The contributed funds will not “accrue to” the society as it has no legal entitlement to the funds.

In a contributing burial society, funds are contributed over time and can only be accessed by the member when death occurs. Since the society has the responsibility to ensure that enough funds are available to pay out benefits, investment opportunities may be sought. In doing so the society would have used the contributed funds as its own funds. It was shown that the society will receive the contributed funds beneficially. The funds will also “accrue to” the society, as the society has a legal right to claim contributions through the contracts with the members. If the society has the right to invest the funds collected in the form of contributions, it was argued that it would be carrying on an operation of business in a scheme for profitmaking and therefore the contributions will not be of “capital nature”. The potential investment income will be “revenue in nature”, as the invested contributions (the “tree”) will produce the investment income (the “fruit”).

In an entertainment Stokvel funds are contributed on the day of the event and given to the member hosting the entertainment event. The Stokvel does not invest any effort in

organising the event, but rather provides a platform where funds are collected and advanced to the hosting member. Therefore, the study showed that the Stokvel will not beneficially receive the contributed funds. The funds will not “accrue to” the Stokvel, as the Stokvel does not have a legal right to the contributed funds.

A purchasing power group or cooperative buying society is established with the purpose of facilitating bulk purchases. The Stokvel will not beneficially receive the contributions, as the contributed funds are used to purchase goods on behalf of the members. As the Stokvel is not the legal owner of the funds, and therefore does not have a legal right to the funds, the funds will not “accrue to” it.

Finally, chapter 3 dealt with the gross income implications of an investment Stokvel. It was shown that the Stokvel essentially operates a business in a scheme of profitmaking, and therefore will beneficially receive the contributed funds. The contributed funds will also “accrue to” the Stokvel as it has a legal right to the contributions. The contributed funds will be “capital in nature”, as they will be used to acquire an income producing asset or provide seed capital for a business. The income produced by the asset or the business venture will be “revenue in nature”. Some investment Stokvels use the contributed funds to issue credit to members and non-members. The study showed that the interest income will be “received by” the Stokvel on its own behalf and for its own benefit. Furthermore, the income will “accrue to” the Stokvel, as it has a legal right to the interest income, which is afforded by the contracts with the loan recipient.

7.2.3 “Gross income” considerations – Stokvel member’s perspective

In chapter 4 the gross income considerations with respect to the funds flowing from the Stokvel to the member were discussed. Regarding a member of a collection burial society the research showed that the funds contributed by other members on the death of a member’s beneficiary will not be included in his or her “gross income”, being a return of contributions made by the member (or to be made) on the death of the beneficiaries of other members. The study revealed that contributions will not be a donation, as the member will be making contributions to other members. For the contributions to be regarded as a donation it needs to be for no consideration or for free.

The study showed that a member of a contributing burial society will receive the funds on his or her own behalf and benefit, after the death has been reported. It was shown that the funds will not “accrue to” the member as the member will not be “unconditionally entitled” to the funds, as the funds can only be accessed after death. It was concluded that the payment of the contributions by the member could be regarded as premiums for a funeral policy and the payment received in respect of a claim will be of a capital nature. Even if the proceeds are included in gross income, however, the proceeds will be exempt in terms of section 10(1)(g), and thus no income tax consequences would arise.

In entertainment Stokvel a hosting member receives the contributions from other members on the day of the entertainment event. The member also stands to generate income from the sale of food and drinks. The member will, therefore, receive the contributions and proceeds from the sale of food and drinks on his or her own behalf and benefit. The contention was based on the premise that the contributing members are paying for an entertainment event. Since the contributed funds and income from the sale of food and drinks are actually received in cash by the member on the day of the event they will therefore, not “accrue to” the member. Since the hosting member receives the contributions from the provision of entertainment and the income from the sale of food and drinks, the contributions and the proceeds will not be “capital in nature” but “revenue in nature” and fall to be included in gross income.

A purchasing power group or cooperative buying society buys grocery items or other goods on behalf of the member. It was therefore, concluded that there are no income tax consequences, as the member receives a refund of his or her own contributions in the form of items purchased by the Stokvel. The study revealed that the Stokvel may invest the contributed funds on behalf of the members. Interest will be therefore be earned and will be “received by” the member, since it was shown in chapter 3 that the Stokvel will not receive the interest on its own behalf and benefit as it will “accrue to” the members who have a legal right to the interest income. Section 24J will however, not apply to the interest income, as it will be earned by the Stokvel on the pool of contributed funds and not invested directly by the member. The members may however qualify for an interest income exemption in terms of section 10(1)(i) of the Income Tax Act.

Chapter 4 finally dealt with the gross income implications of a member of an investment Stokvel who receives a share of income generated from the income producing asset or business acquired with the members' contributions. Therefore, the share of the income will be "received by" the member on his or her own behalf and for his or her own benefit. On whether the share of income will "accrue to" the member, the research contended that that would depend on what the Constitution of the Stokvel prescribes in relation to the distribution of the income. For example, the Constitution may prescribe that the income can only be distributed if a specific return is achieved by the Stokvel. In that regard, the member will not be "unconditionally entitled" to the income, and therefore the income will not "accrue to" the member. In the absence of any condition, the income will "accrue to" the member. The share of the income will be regarded as "revenue in nature" since it is produced by the contributions invested in the Stokvel.

7.2.4 Deductibility of expenses – Stokvel perspective

In chapter 5 the deductibility of expenses by the Stokvel was discussed. Through examination of the collecting burial society's activities, the study showed that it is not "carrying on a trade" and thus no deductions in terms of section 11(a) or any other section will be allowed. The society essentially exists to provide emotional support when death occurs and collects contributions to forward them the affected member.

Regarding a contributing burial society, it was shown that it is "carrying on a trade" of providing funeral policies. Through the application of the general deduction formula it was shown that the claims paid by the society to members will qualify for deduction under section 11(a). The claims will be "in the production of income" and "not of a capital nature".

Regarding an entertainment Stokvel, it was shown that it is not carrying on a trade. The Stokvel essentially exists to collect the funds and forward them to the member hosting the event. The responsibilities attached to hosting the event rests with chosen member. Therefore, the Stokvel will not be allowed any deductions.

A purchasing power group or cooperative buying society will not be regarded as carrying on a trade, as the Stokvel generates no income and incurs no expenses.

Therefore, it was unnecessary to consider the application of the general deduction formula.

Finally, the deductibility of expenses of an investment Stokvel was discussed. An investment Stokvel may invest the contributions as seed money for a business, invest in a rent-producing property or financial instruments, or use the contributions for money lending purposes. With regard to the letting of property, the Stokvel will be “carrying on trade”. It was shown through application of the general deduction formula that the payment of the share of profits to the members will qualify for a deduction under section 11(a). Furthermore, the Stokvel may qualify for deductions under section 11(a) (operating expenses), section 11(d) (repairs and maintenance), section 11(h) (lease premiums or leasehold improvements), and capital allowances in terms of sections 13, 13sex or 13quin, provided that the requirements of those sections are met. An investment Stokvel may invest the contributions in financial instruments. The research indicated that if the Stokvel trades a share dealer, it will be operating a scheme of profit making and thus qualify for a deduction of the cost of the instrument and related expenses (bank charges, internet access charges, cost of telephone calls and technical analysis software), as being incurred in the production of income and not of a capital nature. The study revealed that the payment of profits to members will also be an expense incurred in the production of income and not of a capital nature. If, however, the Stokvel holds the financial instrument as an investment, it will not be “carrying on a trade” and thus no deductions will be available to it.

An investment Stokvel may also use the contributions to operate a money-lending operation. In that case, the Stokvel will be “carrying on trade” as a money lender, as it charges above market related interest, which would indicate the intention to make a profit. The payment of profits to members and other expenses (interest, raising fees and losses on irrecoverable loans) incurred in the process of earning the interest income, will qualify for deduction under section 11(a).

7.2.5 Deductibility of expenses – Stokvel member’s perspective

In chapter 6 the deductibility of expenses by the Stokvel member in relation to the funds received from the Stokvel was discussed. For a member of a collecting burial society, no deductions will be permitted in terms of section 23(f) of the Income Tax Act,

as it was established in chapter 4 that the contributions received are not included in “gross income”. Regarding the member of a contributing burial society, it was revealed that the payment of the contributions could be regarded as a payment for a funeral policy. If the contributions received are likened to a form of insurance, the proceeds received by the member are likely to be capital in nature, but even if they are included in “gross income”, they will be exempt in terms section 10(1)(g) of the Income Tax Act. The payment of the contributions will therefore not be deductible as they will be prohibited by section 23(f) as they do not produce “income” as defined.

The research showed that a member of an entertainment Stokvel is “carrying on a trade” as the member’s activities in hosting the event warrants that status. The member is essentially providing an entertainment event in return for the contributions received from the other members. Application of the “general deduction formula” showed that the expenditure incurred by the member will qualify for a deduction under section 11(a). Those expenses may include the purchase of supplies used in hosting the event. Furthermore, the contribution made the member on the day of the event will not qualify for deduction under section 11(a), as the member is essentially paying for an entertainment event which will not produce income.

With respect to the member of a purchasing power group or cooperative buying society, no deductions will be allowed. As the value of the grocery items is not included in the member’s gross income, section 23(f) of the Income Tax Act will prohibit “the deduction of expenses incurred in respect of any amounts received or accrued which do not constitute income as defined”. Furthermore, being private or domestic expenses, these will be prohibited by section 23(b).

Lastly a member of an investment Stokvel will not be “carrying on a trade” and therefore no deductions will be allowed against the income received from the Stokvel. This conclusion was based on the fact that the member engages in no active steps in relation to his or her investment.

7.3 Conclusion

Much has been researched on Stokvels from socio-economic (Lukhele, 1990; Bester *et al*, 2005; Irving, 2005; Verhoef, 2001) and economics (African Response, 2012; Calvin and Coetzee, 2010; Fin24; Mashigo and Schoeman, 2010; Thompson and

Posel, 2012; Schulze, 1996; Wegelin, 2016) viewpoints. However, little has been written on the South African income tax implications of a Stokvel. It was, therefore, the purpose of this thesis to discuss the South African income tax implications of a Stokvel. Case law and legal principles were referred to in understanding the various income tax implications. Although the case law used in this study dates back many years, the principles established by the courts have proven to still be applicable. Considering the growth of the Stokvel market, it is necessary to consider the income tax implications.

Through application and interpretation of case law and sections of the Income Tax Act, the study has indicated that there may be tax obligations that may be attached to belonging to a Stokvel and equally so for the Stokvel organisation. On the other hand, the study indicated that they may be tax benefits that may be available to the Stokvel and the member in relation to the funds circulating within the Stokvel. In light of the spending power of the Stokvel market and the reported membership size, it is recommended that an interpretation note on how to address the income tax implications of the Stokvel funds be issued by SARS. The interpretation note may consider the different type of Stokvels, possible amounts that circulate in the Stokvel , the distribution of those amounts and address the implications from the member's perspective and that of the Stokvel organisation. In conclusion, an area of further research may consider the study of the Value Added Tax implications for the Stokvel organisation and possibly from the member's viewpoint.

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