

**THE CONTRIBUTION MADE BY MR JUSTICE EF
WATERMEYER TO SOUTH AFRICAN TAX JURISPRUDENCE**

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ABSTRACT

The objective of this thesis is to highlight the colossal contributions made by the late Justice Watermeyer to South African tax jurisprudence. His contributions are viewed from a practical application point of view as well as from a statutory interpretative perspective. The style and technique with which he delivered his judgments are also considered to be a contribution in their own right. The core of this thesis is the analysis of seven of Justice Watermeyer's most influential judgments. The development and application of the principle or principles developed in each of these seven judgments is then traced chronologically through case law up until recent judgments. It is most notable that each and every phrase contained in section 11(a) of the Income Tax Act has been interpreted by Justice Watermeyer. These interpretations are still viewed as correct statements of the applicable law and will continue to be referred to on a regular basis given the fact that section 11(a) is one of the most widely contested provisions in the Income Tax Act. Several references to his approach to statutory interpretation are made through the course of the case analyses. Whilst significant evidence of a purposive oriented approach to interpretation appears in some judgments, such evidence is lacking in others. An absolute or conclusive submission in terms of his approach to statutory interpretation is not sufficiently supported. His style of judgment is also referred to and commented on, with particular focus placed on his use of illustrative examples. The contribution to South African tax law by Justice Watermeyer is found to be nothing short of enormous. He was and continues to be influential with respect to section 11(a), the definition of gross income in section 1, common law principles of tax avoidance as well as the interpretation of statutory laws of tax avoidance. It is anticipated that some of his interpretations with respect to statutory rules of tax avoidance will be referred to when the relatively new anti-avoidance provisions become the subject of litigation.

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CHAPTER ONE: INTRODUCTION

1.1 Mr Justice EF Watermeyer: A biographical summary

The late Mr Justice Ernest Frederick Watermeyer was born on 12 October 1880 in Graaff-Reinet. After starting school in 1888 at Graaff-Reinet College, he left, in the same year, to attend Stellenbosch Gymnasium where he remained until 1894. Whilst at Stellenbosch Gymnasium, Ernest, together with his older brother and younger sister, resided at his uncle's farm in Jonkershoek. It is interesting to note, as an aside, that Ernest, together with his brother, were responsible for the liberation of the first trout into South African waters. In 1894 Ernest proceeded to join Bath College in England. Watermeyer excelled in various facets of school life whilst at Bath. He held the position of senior prefect and captained both the rowing and cricket teams.¹ It has been reported that one of his fellow scholars at Bath once remarked that Watermeyer exhibited "extreme fairness of mind"² in his capacity as a senior prefect. Towards the end of his school career Watermeyer began to specialise in mathematics. He won an entrance scholarship to Caius College and proceeded to Cambridge in 1899. He read for a mathematics degree and continued to excel in rowing. He received his degree in June of 1902 whereafter he decided to visit South Africa for a brief period. He returned to Cambridge in November of that year and began to read for a law degree. He passed the second part of what was then known as the "Law Tripos"³ in June 1903. This qualified him to write the Bar examinations in South Africa. Between his acquiring a legal degree and his return to South Africa Watermeyer travelled extensively through Europe visiting countries such as Romania and Hungary. After successfully completing the Bar examinations in South Africa, Watermeyer began at the Bar in 1904.⁴

¹ GGS (only initials available) "Mr Justice Watermeyer" (1923) 40 *SALJ* 99 at 99-100.

² MD Southwood "Fathers and their Children on our Bench" (1990) *Consultus* 28 at 29 <http://www.sabar.co.za/law-journals/1992/October/1992-october-vol005-no2-pp127-130.pdf> (accessed 04/09/2009).

³ GGS 1923 *SALJ* 102.

⁴ GGS 1923 *SALJ* 102.

The first few years proved to be an extremely difficult time at the Bar. Watermeyer, together with the rest of the profession, battled to endure the depression that had set in following the Anglo-Boer war. He was married in 1908 and by 1912 was beginning to gain the respect of both his peers and the courts alike. His success as an advocate began to increase rapidly during this period.⁵ By 1913 he had become extremely well recognised and was known for his consistent ability to impress the courts with his lucid and clear arguments. In 1913 he joined the Cape Garrison Artillery regiment and rose to the rank of captain. He was demobilised in 1919 and appointed Chairman of the Special Income Tax Court in August of 1920. It was suggested that his sound knowledge and keen interest in mathematics “stood him in good stead”⁶ for the position. He was appointed to the Cape Provincial Division – in an acting capacity – in both August 1920 and October of the same year. Throughout this period his practice as an advocate had been growing and he was considered to be in the “very best class of professional work.”⁷ He took Silk in September 1921 and was appointed – in a permanent capacity - to the Cape Provincial Division in June 1922.⁸ He was a permanent feature of the Cape Provincial Division for approximately fifteen years whereafter he was appointed to the Appellate Division in 1938. It must be noted that he acted as a Judge of Appeal in 1937 but not on a permanent basis.⁹ He became Chief Justice of the Appellate Division and a member of His Majesty’s Privy Council in 1943 where he remained until the 12 October 1950 when he retired.¹⁰ He passed away in 1958 at the age of seventy-eight.¹¹

1.2 The context of the research

Justice Watermeyer, for a period of approximately twenty-eight years, made various contributions to the law of South Africa in all fields. He was an ardent Roman-law enthusiast and this enthusiasm was evidenced by his painstaking research and careful

⁵ GGS 1923 *SALJ* 103-104.

⁶ Southwood 1990 *Consultus* 29.

⁷ GGS 1923 *SALJ* 104.

⁸ GGS 1923 *SALJ* 105.

⁹ CG Hall (ed) “The New Chief Justice” (1943) 60 *SALJ* 429 at 429.

¹⁰ HR Hahlo and RG Mckerron (ed) “The RT Honourable E.F. Watermeyer” (1950) 67 *SALJ* 332 at 332.

¹¹ Southwood 1990 *Consultus* 29.

analysis and understanding of the old authorities in his judgments.¹² Whilst it is conceded by the writer that Roman-Dutch law has, almost, no bearing on the application of tax law principles, it is suggested that Watermeyer's appetite for lengthy and considered research and analysis was an important factor aiding the valuable contribution he was to make to South African tax law. This careful scrutiny and considered research of legal intricacies was further evidenced by his approach to the maxim of *stare decisis*. Whilst recognising the importance and fundamental nature of this maxim, he was not afraid to analyse whether the highest authority was, possibly, incorrect. It was this enthusiasm for the attainment of justice in all respects that lead him to conclude that there are times – though rare - when the maxim should not be applied.¹³ It is submitted that such a ruling was typical of his enquiring and meticulous nature. These qualities and the man himself were to have a lasting effect on South African tax law in the form of various 'landmark' judgments. The fact that these 'landmark' decisions interpreted some of the most widely contested provisions of the Income Tax Act¹⁴ (hereafter referred to as 'the Act') – for example, section 11(a) which will be quoted in chapter three – makes his contributions all the more extraordinary.

Watermeyer's judgments were presented in an impeccable and, almost, lecture-like fashion. His explanations and use of analogies and examples provides the reader with an excellent sense of understanding. His structure and lucid explanation of the facts and principles under consideration make his judgments – even those dealing with highly complex sets of facts – understandable for, even, the most junior of academics. This is in stark contrast to many judgments – both new and old – where, even, experienced academics battle to understand why a particular conclusion has been arrived at. Watermeyer is referred to regularly in all South African tax textbooks and other scholarly tax publications. He is referred to regularly by our courts as authority for some of the most fundamental principles of our taxation system. A brief overview of the judgments to be analysed will be embarked upon at the end of this chapter. It should be noted that tribute writers at the time of Watermeyer's death appeared to have underestimated the

¹² Hahlo and Mckerron (ed) 1950 *SALJ* 333.

¹³ Hahlo and Mckerron (ed) 1950 *SALJ* 334.

¹⁴ Act 58 of 1962.

contribution made by him to tax law and rather concentrated on his contributions made in other branches of law.

1.3 The purpose and importance of the research

The object of this research is to highlight the extraordinary achievements made by Mr Justice EF Watermeyer in the field of tax law. It is undertaken in recognition of these achievements and is, in essence, a celebration thereof. This thesis aims to convey a sense of admiration and appreciation of the contributions made by Mr Justice Watermeyer as well as a thorough understanding of the principles articulated by him. It is also important because it is believed that modern-day judges and academics dealing with taxation issues may learn something from the way in which his judgments were articulated and explained. In other words it is not only the practical principles and interpretations that are important; the manner and style of his judgments are also of significant importance and a major contribution in their own right. In this regard this thesis will provide an example of a style of argument that is lucid, simple and understandable. Watermeyer's purposive tendencies with respect to statutory interpretation have also been referred to throughout the thesis. Evidence of such an approach was, however, erratic and has been highlighted where relevant. It must be emphasised that the approach to statutory interpretation in the years in which Watermeyer sat as a member of the judiciary was, generally speaking, dominated by the literalist school of thought. Any tendency towards a purposive approach must, therefore, be regarded in the context of the time in which Watermeyer sat, as ground-breaking. The different approaches to statutory interpretation will be discussed from a critical perspective in the following chapter.

1.4 The research methodology employed

The research methodology employed in this research is legal interpretative – that is, it is situated in the qualitative methodology. In achieving the stated object of the research, the following literature sources were analysed, discussed or referred to:

- Income tax legislation;
- case law, including both Watermeyer's judgments as well as others where his judgments were referred to either directly or indirectly;
- biographical articles;
- textbooks and various articles aiding the process of illustrating the significant achievements of Watermeyer in the field of tax law.

Seven of Watermeyer's most well known judgments have been analysed with reference to subsequent case law. The contributions of each decision – including the style of judgment, the approach, where discernible, to statutory interpretation as well as the practical contributions thereof – have been highlighted.

As all the data are in the public domain, no ethical considerations arise.

1.5 Overview of the chapters to come

Chapter two will provide the reader with an introduction to the subject of statutory interpretation. It is important to understand the basic approaches to statutory interpretation in order for the remainder of the thesis to be fully appreciated. Chapter three consists of an analysis of three judgments. All three judgments were delivered before Watermeyer's rise to the position of Chief Justice. It must be noted that his judgments are discussed in chronological order.

Watermeyer's first major decision that is still regularly referred to by our courts and academics alike was that of *Lategan v CIR*.¹⁵ The words 'amount' and 'accrued' were considered in relation to the then definition of gross income which according to section 6 of the Act stated that gross income was defined as:

¹⁵ 1926 CPD 203.

The total *amount* received or *accrued* to or in favour of any person other than receipts or accruals of a capital nature in, any year or period assessable under this chapter from any source within the Union or deemed to be within the Union, and ... (own emphasis)¹⁶

It was held by Watermeyer that the word ‘amount’ must be given a wide interpretation in order to give effect to the intention of the Legislature. In other words if the word ‘amount’ was given a narrow meaning confined to only monetary amounts the taxpayer would be free to receive payment in a form other than money, thus escaping taxation. The phrase ‘accrued to’ was held to merely mean “to which he has become entitled.”¹⁷ In other words amounts that are due but remain unpaid are assessable. A right to payment must have accrued. It is interesting to note that the Legislature, subsequent to this case, amended the definition of gross income by adding the words “in cash or otherwise” after the word ‘amount.’ This was quite obviously done with the intention to quash any possible controversies that may arise in relation to the word ‘amount.’ It is notable that Cloete JA in the very recent case of *C:SARS v Brummeria Renaissance*¹⁸ - concluded in 2007 – referred authoritatively to Watermeyer’s judgment in the *Lategan* case.

The second judgment discussed in chapter three is the case of *Port Elizabeth Electric Tramway Co Ltd v CIR*.¹⁹ The dispute was primarily focused on the deductibility of damages payments and the legal costs associated therewith with respect to section 11(2)(a) of the Act. Section 11(2)(a) was materially the same as the current section 11(a) and read as follows:

The deductions allowed shall be:-

- (a) expenditure and losses actually incurred in the Union in the production of the income, provided such expenditure and losses are not of a capital nature.²⁰

The current section 11(a) will be quoted in chapter three. It was a short and well structured judgment which has been quoted on numerous occasions by subsequent courts.

¹⁶ Act 41 of 1917.

¹⁷ *Lategan v CIR* 209.

¹⁸ 69 SATC 205.

¹⁹ 8 SATC 13.

²⁰ Act 40 of 1925.

Several passages have been quoted from this judgment by successive decisions but the most often cited passage reads as follows:

Here, in my opinion, all expenses attached to the performance of a business operation *bona fide* performed for the purpose of earning income are deductible whether such expenses are necessary for its performance or attached to it by chance or are *bona fide* incurred for the more efficient performance of such operation provided they are so closely connected with it that they may be regarded as part of the cost of performing it.²¹

Other elements as well as the conclusion of this judgment have been addressed below. There have been several recent judgments which have referred to the *Port Elizabeth Electric Tramway* decision – most notably the Supreme Court of Appeal in the case of *Warner Lambert SA v CIR*²² and the same court in the case of *Ticktin Timbers CC v CIR*²³ four years earlier.

The final judgment considered in chapter three is that of *Commissioner of Customs and Excise v Randles Brothers and Hudson*.²⁴ The common law principles with respect to the requirements of what constitutes a disguised or simulated transaction for the purposes of tax avoidance are discussed. It must be noted that two dissenting judgments were delivered. Watermeyer's judgment is highlighted as being a most logical and stimulating argument. Watermeyer made reference to the case of *Zandberg v Van Zyl*²⁵ which is still regarded as the *locus classicus* on the issue of simulated transactions. The court in the recent case of *Erf 3183 / 1 Ladysmith (Pty) Ltd v CIR*,²⁶ in coming to its conclusion, relied heavily on Watermeyer's *Randles Brothers* judgment together with the *Zandberg* decision. The judgment in the *Ladysmith* case has, in effect, recognised both judgments as primary authority when determining whether a taxpayer has entered into a simulated transaction. This is particularly noteworthy when it is considered that four separate judgments were delivered in the *Randles Brothers* decision. The only one acknowledged

²¹ *Port Elizabeth Electric Tramway v CIR* 17-18.

²² 65 SATC 346.

²³ [1999] 4 All SA 192 (A).

²⁴ 33 SATC 48.

²⁵ 1910 AD 302.

²⁶ 58 SATC 229.

by the court in the *Ladysmith* decision was Watermeyer's. Watermeyer's contributions to tax avoidance were to be magnified in the case of *CIR v King*²⁷ discussed in chapter four.

Chapter four catalogues Watermeyer's contributions to tax law during his time as Chief Justice of South Africa. The first of three major decisions he was to deliver in six months was in the case of *Joffe v CIR*.²⁸ Once again at issue was section 11(2)(a) with respect to damages payments and the legal costs associated therewith. This judgment, while providing an often cited interpretation of the phrase 'expenditure and losses,' was the least appealing judgment of the seven discussed. Watermeyer, in losing sight of the specific argument put forward by the taxpayer, delivered a, somewhat controversial decision. He also appeared to adopt a narrower formulation of what constitutes deductible expenditure in terms of section 11(2)(a) – a formulation that has been ignored in favour of his regularly referred to *PE Electric dicta*. His subsequent decision in the case of *CIR v Lever Brothers & Unilever*²⁹ was, however, one of his greatest achievements in terms of style, manner and practicality.

The case of *CIR v Lever Brothers & Unilever* provided a rather complex set of facts involving various agreements. The dispute was crisply isolated to the issue of the source of a particular receipt.³⁰ It must be remembered that South Africa operated a source-based system of taxation up until the end of 2000. The beginning of 2001 marked the beginning of a residence-based system of taxation.³¹ In other words a resident is taxed on income regardless of its source. It must be remembered, however, that non-residents are still taxed on a source-based system. The meaning ascribed to the word 'source' in the definition of gross income in section one of the Act is, therefore, only relevant to disputes involving non-residents. The reader is referred to the definition of gross income quoted in chapter three. Watermeyer not only presented a two pronged test aimed at establishing the 'source' of a particular receipt that became widely used and authoritative, but also

²⁷ 14 SATC 184.

²⁸ 13 SATC 354.

²⁹ 14 SATC 1.

³⁰ RC Williams *Income Tax in South Africa Cases and Materials* 2 ed (2005) 70.

³¹ Williams *Income Tax in South Africa Cases and Materials* 18.

adopted the phrase ‘originating cause’ in determining the meaning of source. His famous statement of the law with regard to the interpretation of the word ‘source’ was as follows:

In this section it is used figuratively, and when so used in relation to the receipt of money one possible meaning is the originating cause of the receipt of the money, another possible meaning is the quarter from which it is received. A series of decisions of this Court and of the Judicial Committee of the Privy Council upon our Income Tax Acts and upon similar Acts elsewhere have dealt with the meaning of the word “source” and the inference, which, I think, should be drawn from these decisions is that the source of receipts, received as income, is not the quarter from whence they come, but the originating cause of their being received as income and that this originating cause is the work which the taxpayer does to earn them, the *quid pro quo* which he gives in return for which he receives them. The work he does may be a business which he carries on, or an enterprise which he undertakes, or an activity in which he engages and it may take the form of personal exertion, mental or physical, or it may take the form of employment of capital either by using it to earn income or by letting its use to someone else. Often the work is a combination of these.³²

This conclusion as to the meaning of the word ‘source’ has never, since, been doubted. Evidence of this lies in the fact that this judgment is, invariably, referred to in any case dealing with the interpretation of the word ‘source’ as it appears in the definition of gross income in section one of the Act. The structure, style and employment of analogy created an excellently composed and most comprehensible argument. These features will be elaborated on in chapter four.

The last major judgment to be delivered in a busy six months for Watermeyer was in the case of *New State Areas v CIR*.³³ This judgment is, almost certainly, the most regularly referred to and most often cited Watermeyer judgment with respect to tax law. It dealt with the issue of what constitutes revenue expenditure as opposed to capital expenditure. Revenue expenditure is deductible whereas capital expenditure is not. The reader is referred to section 11(2)(a) quoted above in this regard. In a meticulous and exceptionally well structured judgment which surveyed various English and South African authorities Watermeyer came to the following conclusion:

³² *CIR v Lever Brothers and Unilever* 8.

³³ 14 SATC 155.

The conclusion to be drawn from all these 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. Its true nature is a matter of fact and the purpose of the expenditure is an 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 a revenue expenditure even if it is paid in a lump sum.³⁴

This passage has been quoted on countless occasions by subsequent courts, textbooks and scholarly articles alike. It is also interesting to note that he refers to both his *PE Electric* and *Joffe* decisions during the course of this judgment.

The final case discussed is that of *CIR v King*.³⁵ Whilst Watermeyer's contributions to common law principles of tax avoidance were highlighted in the case of *Randles Brothers*, he was to magnify his influence on the issue of tax avoidance in this case by interpreting section 90 of the Act. Section 90 was the relevant general anti-avoidance provision in 1947. It was replaced by section 103(1) in 1959 which was to be amended in 1978 and then again in 1996. Section 103(1) was replaced, in 2006, by sections 80A – 80L.³⁶ Despite the fact that Watermeyer's judgment in the *King* case was based on a provision which has been substituted twice, it remains influential in terms of the interpretation of section 80A. Watermeyer's adoption of the Provincial Division's interpretation of the meaning of 'purpose' as used in section 90 found legislative recognition in both section 103(1) and section 80A. Watermeyer's statement with respect to what does not constitute an avoidance scheme is quoted by De Koker and Williams as a valid statement of the law.³⁷ The full effect of the *King* decision on section 80A is made clear in chapter four.

The importance of these judgments cannot be underestimated as they interpreted some of the most contested provisions in the Act. The provisions or words interpreted by

³⁴ *New State Areas v CIR* 170.

³⁵ 14 SATC 184.

³⁶ A De Koker and R Williams *Silke on South African Income Tax* (Updated annually – Service Issue 38) para 19.2.

³⁷ De Koker and R Williams *Silke on South African Income Tax* para 19.5.

Watermeyer are not defined in the Act and judicial interpretation thereof is vital in order to maintain legal certainty.

CHAPTER TWO: THEORIES AND APPROACHES TO STATUTORY INTERPRETATION

2.1 Introduction

The subject of statutory interpretation has been and will continue to be a highly controversial and contested branch of law. Simplistically, the subject involves the deriving of meaning from enacted statutes. There is, however, a multitude of differing opinions on how one is to approach this subject.³⁸ Some academics have even questioned whether it is a subject at all.³⁹ While it is, essentially, a practical discipline, it is bedevilled by an almost insurmountable array of contradictory jurisprudential and philosophical theory. Such theory is, furthermore, inextricably linked to political issues. A very obvious example of how political issues affect the subject of statutory interpretation is South Africa's transition from a political system based on parliamentary sovereignty to a system of constitutional supremacy.⁴⁰ The courts are now allowed, in fact, obliged to interpret enacted legislation against the backdrop of the Constitution which entrenches first, second and third generation rights.⁴¹ Where a statute infringes one or more of these rights it will be interpreted either in a way which does not give effect to the infringement or it will be struck out completely and declared unconstitutional and, therefore, invalid. This was not so under the previous dispensation, where enacted legislation was supreme due to the fact that parliament was considered sovereign. The effect of this change in our political structure on statutory interpretation will be referred to again at a later stage.

Political and societal issues are, evidently, constantly in flux which makes the delineation of a workable theory of statutory interpretation even more complex. The subjective

³⁸ GE Devenish *Interpretation of Statutes* (1992) 25.

³⁹ DV Cowen "Prolegomenon to restatement of the principles of statutory interpretation" 1976 *TSAR* 131 at 133.

⁴⁰ GE Devenish *The South African Constitution* (2005) 5.

⁴¹ I Currie and J de Waal *The Bill of Rights Handbook* 5 ed (2005) 147.

beliefs and experiences of the individual interpreter also contribute to the complexity of the matter. An interpretation in the words of de Ville:⁴²

...may be inspired by a judge's moral and political beliefs, by unconscious, irrational factors, and/or by legal knowledge.

One judge, for example, may be more concerned with the attainment of justice while another may be equally concerned with the exact letter of the law. What is clear, already, is that the subject of statutory interpretation is far from settled. It is unfortunately not possible, given the scope and subject of this thesis, to present a philosophical analysis and critique of all the various approaches to statutory interpretation. Only the main approaches will be discussed and criticised. There are a number of lesser known approaches that will not be dealt with.

The fundamental or underlying reasons for the vast range of theoretical divergences on the approach to statutory interpretation can, at least to some extent, be categorised. Cowen suggests that they are as follows:⁴³

1. The relevance, if any, of "the intention of the legislature."
2. The nature and functions of language.
3. The role of the judiciary in the interpretation of statutes.
4. The time-frame within which statutes operate.

These four points will be expanded on during the course of the following discussion as and when they become relevant. It must be emphasised that this thesis is not a discourse on statutory interpretation in any way. It must be noted, in line with this, that the presumptions of statutory interpretation are well beyond the scope of this thesis and, as such, will not be discussed or referred to. A basic grasp of the subject and an appreciation of the difficulties inherent in the subject of statutory interpretation are, however, required in order for the reader to fully comprehend the subsequent chapters. These chapters will expose and catalogue the contributions made by Watermeyer to

⁴² J de Ville "Meaning and statutory interpretation" (1999) 62 *THRH* 373 at 384.

⁴³ Cowen 1976 *TSAR* 150.

South African tax law, not only from a practical perspective, but also from an interpretative perspective. It should also be noted at this stage that fiscal legislation such as the Income Tax Act is interpreted in the same fashion as ordinary legislation.⁴⁴ It is, therefore, not necessary to discuss statutory interpretation in the context of fiscal legislation as it is no different to any other context.

Apologies should be made in advance to any reader who prefers highly structured academic writing. This chapter on the approaches to statutory interpretation does not, unfortunately, lend itself to such structure due to the subject's inherently unclear and inarticulate nature. Many of the approaches to or theories of statutory interpretation overlap and, at times, are almost indiscernible. The reader must also be alert to the danger of labelling an approach in a specific fashion. One person's understanding of a particular approach may very well be different to the next.⁴⁵ This feature of statutory interpretation only adds more fuel to the flames of confusion that abound within this discipline. An attempt, however, at some kind of structure is made. There will be two main sections. The first will discuss the literal approach to statutory interpretation from its most primitive form to a more modern application. Approaches that are linked to or rooted in the literal approach will also be discussed under this section. The concepts of intentionalism as well as the theory known as the literalism-cum-intentionalism theory are examples of linked approaches. The second section will concentrate on the purposive approach to statutory interpretation. Included in this section will be a discussion of the teleological or value-coherent approach as well a brief discussion of contextualism. Reference to the advent of the constitutional era and its impact on statutory interpretation will also be made.

2.2 The Literal approach

The literal approach, also referred to as the textual approach, idolises the actual text or words of the specific provision of the statute under consideration. It has absolutely no

⁴⁴ GK Goldswain "The purposive approach to the interpretation of fiscal legislation – the winds of change" (2008) 16 *Meditari Accountancy Research* 107 at 109.

⁴⁵ G Carpenter "More about language, meaning and statutory interpretation" (1999) 62 *THRHR* 626 at 630.

regard – in its most primitive form – for the purpose or the intention with which it was enacted by the legislature.⁴⁶ It is unrelenting even in the face of extreme hardship imposed on an individual. The governing or primary rule of this approach appears to be that where a provision is unambiguous and clear, it must be applied regardless of the result. No reference to the context or the purpose of the provision in question is sanctioned.⁴⁷ A court is, according to this approach, compelled to apply the specific provision as it stands.

According to the literal theory the governing or primary rule may only be departed from in very specific circumstances.⁴⁸ The first is where the literal application of the provision in question would lead to an absurdity or a result so unjust that it could not have been the intention of the legislature. If a court is satisfied that such a result has occurred it may depart from the literal meaning of the provision. This is known as the golden rule.⁴⁹ The second instance where the primary rule can be departed from is where there is clear ambiguity. In these circumstances a court is able to refer to contextual evidence such as the historical motivation for the enactment under consideration as well as the purpose of such enactment. The provision is then interpreted in light of these considerations. This is known as the mischief rule.⁵⁰

Du Plessis states that the golden rule “has been designed to salvage and not to sink literalism.”⁵¹ It is submitted that the same is equally applicable to the mischief rule. It is also apparent that the literal theory of interpretation would be inoperable without these two rules which provide refuge for the continued survival of the theory. The first criticism of this theory which requires analysis concerns the fallacy of the plain or ordinary meaning of a provision. Cowen points out that words have no meaning when considered in isolation. He goes on to state that “words necessarily take their meaning

⁴⁶ L du Plessis *Re-Interpretation of Statutes* (2002) 93.

⁴⁷ Devenish *Interpretation of Statutes* 28.

⁴⁸ Devenish *Interpretation of Statutes* 28.

⁴⁹ du Plessis *Re-Interpretation of Statutes* 104.

⁵⁰ Devenish *Interpretation of Statutes* 28.

⁵¹ du Plessis *Re-Interpretation of Statutes* 104.

from the whole relevant context in which they are used.”⁵² The following example offered by Cowen is instructive in this regard:⁵³

“Help yourselves,” when uttered by a host at a party means one thing. The same words when uttered by a preacher during a sermon on self-help should not be interpreted as an invitation to rifle the offertory plates.

It will be remembered that one of the four reasons mentioned above for the divergent theories on statutory interpretation was the nature and function of language. Literalists are of the opinion that an interpreter can assign an ordinary meaning to every provision or statute. Critics of the literal approach are, generally, of the opinion that language is inherently ambiguous.⁵⁴ In support of this De Ville states that there “is simply no single, correct meaning to any statutory provision.”⁵⁵ Du Plessis echoes this by stating that “language is a medium of meaning – not meaning itself.”⁵⁶ This quote provides a neat and concise summary of the major downfall of literalism. Meaning is, manifestly, not only derived from words. Other factors – discussed below – need to be taken into account.

The role of the judiciary was highlighted above as being a beacon of divergence separating the various theories of statutory interpretation. The literal theory of interpretation is closely associated with the notion of parliamentary supremacy or sovereignty.⁵⁷ It is also closely associated with the jurisprudential theory of positivism which goes hand in hand with parliamentary supremacy. The theory of positivism rejects values and places a strict divide between law and morality.⁵⁸ If the legislature enacts a statute – no matter how unjust the consequences of its application – a court must apply it

⁵² DV Cowen “The interpretation of statutes and the concept of “the intention of the legislature” (1980) 43 *THRHR* 374 at 386.

⁵³ Cowen 1980 *THRHR* 386.

⁵⁴ Carpenter 1999 *THRHR* 627.

⁵⁵ de Ville 1999 *THRHR* 378.

⁵⁶ L du Plessis “Tentative Reflections on the Systematization of the Rules and Presumptions of Statutory Interpretation” (1981) 98 *SALJ* 211 at 216.

⁵⁷ du Plessis *Re-Interpretation of Statutes* 97.

⁵⁸ Devenish *Interpretation of Statutes* 32.

according to the 'ordinary' meaning of the words. In such a case a court practices judicial deference to the will of the legislature. Devenish states that:⁵⁹

The literal theory ignores moral and policy issues in the process of interpretation and is thus compatible with positivism.

It was not uncommon for a judge to apologise after applying a literal approach that resulted in hardship. This apology was, invariably, qualified by the judge who would state that where a provision is clear and unambiguous, it must be applied.⁶⁰ In summation it is suggested that literalists subscribe to the positive theory of law which has as one of its main principles the concept of judicial deference to the will or intention of the legislature. Put differently; those who believe the function of a judge is to simply apply the law as it stands are of the literalist school of interpretation and adhere to the jurisprudential theory of positivism. This is in stark contrast to the teleological approach to interpretation which is primarily concerned with moral coherency.⁶¹ Natural law as well as constitutional supremacy, as concepts, are both associated with this approach. Judicial activism or law-making, as opposed to judicial deference, is acceptable in a system based on constitutional supremacy.⁶² In other words a judge may stray from, even, the plain meaning of a provision in the pursuit of a just outcome. It must be noted that the teleological approach to interpretation is a wide form of purposivism. It must also be noted that natural law is inextricably linked to morality and values⁶³ and can, therefore, be considered the opposite of positivism.

It is clear from the brief discussion above that a person's attitude or view of the function of the judiciary might have a fundamental bearing on his or her approach to statutory interpretation. Where one is of the opinion that a judge should merely perform the mechanical function of applying the law, it is likely that such a person will be of the literalist school of interpretation. Where a person is of the opinion that a judge's function

⁵⁹ Devenish *Interpretation of Statutes* 32.

⁶⁰ Devenish *Interpretation of Statutes* 28, *Ebrahim v Minister of the Interior* 1977 (1) SA 665 (A) at 680A-B.

⁶¹ Devenish *Interpretation of Statutes* 47.

⁶² C Botha *Statutory Interpretation: An introduction for students* 4 ed (2005) 99-100.

⁶³ Devenish *Interpretation of Statutes* 43.

is the attainment of justice, it is likely that such a person will subscribe to the notion of purposivism. The following sub-section will outline as well as criticise the theory of intentionalism. References to literalism will also be made.

2.2.1 Intentionalism

The intention theory, otherwise known as the subjective theory or will theory, does not, unlike the theory of literalism, equate the intention of the legislature with the ordinary or unambiguous meaning of a statute.⁶⁴ The literal theory considers only the words of the provision in question. Once a meaning has been determined a literalist will label it ‘the intention of the legislature.’ The following statement from Coleridge J is instructive in this regard where it was stated:

The object of all exposition of written instruments must be to ascertain the expressed meaning or intention of the writer, the expressed meaning being *equivalent* to the intention (own emphasis).⁶⁵

The literal approach provides for no distinction between the ordinary meaning of a statute and the intention with which it was enacted. They are deemed to be equivalent. This is possibly due to the literalist’s contention that a ‘plain’ or ‘ordinary’ meaning does, indeed, exist. This contention was heavily criticised above.

Fundamental to the intention theory is the distinction between the intention of the legislature and the written word. In other words thoughts and meanings are regarded independently of each other.⁶⁶ This is clearly a more advanced and equitable approach to statutory interpretation. It is, however, far from flawless. The question that is so regularly posed by academics concerning this approach relates directly to the meaning of ‘the intention of the legislature.’⁶⁷ It will be remembered from the introduction to this chapter that the relevance of this phrase is considered to be a fundamental reason for differing opinions on the approach to statutory interpretation. When one actually

⁶⁴ Cowen 1976 TSAR 152.

⁶⁵ *Shore v Wilson* 9 C1 & Fin 525 quoted in Cowen 1976 TSAR 152.

⁶⁶ *Devenish Interpretation of Statutes* 33, Cowen 1976 TSAR 153.

⁶⁷ *Devenish Interpretation of Statutes* 33.

considers the composition of a legislature the question becomes all too glaring to ignore. Legislation is often the result of compromise and debate. Members of the legislature may have divergent views as to what the meaning or purpose of the legislation is.⁶⁸ In other words there cannot be one uniform intention. Du Plessis states that ‘intention of the legislature’ has “a strongly subjective connotation.”⁶⁹ Intention is, therefore, associated with subjectivity. It is, however, extremely problematic to attempt to determine what was in the ‘mind’ of the legislature when no such ‘mind’ exists. It is a composition of people with different opinions, biases and prejudices. A possible defence of intentionalism is to state that ‘the intention of the legislature’ is merely a legal fiction⁷⁰ – not to be taken literally (excuse the pun). It must be noted that legal fictions are regularly used in a number of branches of law to simplify “complex phenomena.”⁷¹ Once ‘the intention of the legislature’ is regarded as a legal fiction it becomes more defensible for the simple reason that it becomes more objective in nature. The relevance of ‘the intention of the legislature’ becomes less important as it no longer enquires into the non-existent ‘mind’ of the legislature but looks more to the purpose of the enactment. Du Plessis opines that this:⁷²

...notion of “the intention of the legislature”, rescued by its very fictitiousness as it were and proclaiming the operational efficacy of enacted law, brings intentionalism in the vicinity of purposivism.

This quote will make more sense once the reader has read the section on the purposive approach to interpretation below. It must be briefly noted that intentionalism in its most extreme form has also been subjected to heavy criticism. Extreme intentionalism treats the so-called ‘intention of the legislature’ as decisive.⁷³ Cowen notes that extreme intentionalism adopts an “Alice in Wonderland attitude to the meaning of the words.” Cowen vigorously rejects this philosophy by stating that:⁷⁴

⁶⁸ Cowen 1976 *TSAR* 154.

⁶⁹ du Plessis *Re-Interpretation of Statutes* 94.

⁷⁰ du Plessis *Re-Interpretation of Statutes* 96.

⁷¹ du Plessis *Re-Interpretation of Statutes* 96.

⁷² du Plessis *Re-Interpretation of Statutes* 96.

⁷³ Cowen 1976 *TSAR* 155.

⁷⁴ Cowen 1976 *TSAR* 155.

...it has no place when a representative and responsible legislature uses the social institution of language in order to regulate social behaviour.

Devenish is equally critical of such a philosophy and refers authoritatively to Cowen in this regard.⁷⁵

The last of the fundamental reasons for differing approaches to statutory interpretation is the time frame within which statutes operate. A pure subjective or intention theory has another major weakness in that it seeks to establish the ‘intention of the legislature’ at the time of promulgation or enactment.⁷⁶ The basic function of law is to regulate society. Society is an ever-changing entity which requires a contemporary, non-rigid approach to statutory interpretation.⁷⁷ A classic example of a court adhering to an historical-intention based theory of interpretation was the American case of *The People v Barnett*.⁷⁸ The word ‘electors’ was in issue. The statute in question was passed in 1874 when only males qualified as electors. By 1921, however, full voting rights had been allocated to women. The court was called on to decide whether, in light of these developments, the word ‘electors’ should be taken to include both men and women. The court held that it meant only males as at the time of enactment, the legislature had intended such a result.⁷⁹ This judgment epitomises one of the major downfalls of intentionalism with respect to the continuing time frame within which statutes operate. The case was decided as if the matter had arisen in 1874 in that it did not take into account the changing values in society. This approach appears to be wholly unsustainable and indefensible. The last approach that will be briefly discussed in this section is typical of the subject of statutory interpretation in that it is a blurring – or confusing – of the two approaches discussed thus far.

⁷⁵ Devenish *Interpretation of Statutes* 35.

⁷⁶ Devenish *Interpretation of Statutes* 35.

⁷⁷ Devenish *Interpretation of Statutes* 35.

⁷⁸ 319 Illinois 403 quoted in Cowen 1976 *TSAR* 156.

⁷⁹ Cowen 1976 *TSAR* 156.

2.2.2 Literalism-cum-intentionalism

The name appears to say it all and it does to some extent. This approach can be described as a marriage between the literal approach and intentionalism. Literalism is stated first in the double-barrelled name due to the fact that it is dominant.⁸⁰ It will be remembered that under the discussion of the literal approach it was stated that the ordinary meaning of a statute was equivalent to the intention of the legislature. There is an extremely subtle difference between literalism and the approach under consideration. The intention is not equivalent to the so-called ordinary or plain meaning of the statute, but it is “knowable because the linguistic form also offers the means to unpack this intention.”⁸¹ This is based on the assumption that linguistic form is precise and certain in nature. This approach, therefore postulates that the intention of the legislature is not equivalent to the ordinary meaning of the language but, rather; the actual intention of the legislature is ascertainable from the language used.⁸² There is an extremely fine line – almost non-existent line – between this approach and pure literalism. It is, however, an interesting example of the subtle but differing approaches to statutory interpretation.

The next section discusses the purposive approach as well as the teleological method of interpretation. The concept of contextualism will also be referred to. It will become immediately noticeable the extent to which the ordinary, grammatical meaning of language is less significant. Cowen’s second point of difference listed in the introduction with respect to the nature of language should be borne in mind. The text is by no means, however, unimportant.

2.3 The Purposive Approach

The mischief rule can be viewed as a “manifestation of a qualified purposive approach.”⁸³ The mischief rule is a qualified purposive approach due to the fact that it can only be

⁸⁰ du Plessis *Re-Interpretation of Statutes* 107.

⁸¹ du Plessis *Re-Interpretation of Statutes* 107.

⁸² du Plessis *Re-Interpretation of Statutes* 107.

⁸³ Devenish *Interpretation of Statutes* 36.

resorted to in cases of clear ambiguity. Purposivism does not prescribe such a qualification. The purposive approach demands a far more flexible attitude to statutory interpretation. It was stated earlier that intentionalism is fettered by the unrealistic notion of determining the subjective will of the legislature. A purposive approach accords to an objective determination of the purpose of the statute in question.⁸⁴ It will be remembered that ‘intention of the legislature’ was a central point of divergence listed in the introduction. Devenish states in this regard that:⁸⁵

. . . this theory does not have as its central thrust the enigmatic and contentious concept of the *intention of the legislature* (own emphasis).

This fluid or vague notion of ‘the intention of the legislature’ was criticised above. It was, however, noted that where ‘the intention of the legislature’ is regarded as a legal fiction it may accord more with the purposive approach and, as such, be less vulnerable to academic attack. The purposive approach is not solely reliant on the grammatical or ordinary meaning of words. It recognises that language is inherently ambiguous, the meaning of which cannot be determined in isolation.⁸⁶ According to Botha:

. . . the purpose or object of the legislation (the legislative scheme) is the prevailing factor in interpretation. The context of the legislation, including social factors and political policy directions, are also taken into account to establish the purpose of the legislation.⁸⁷

This does not, however, mean that the specific words can be completely disregarded.⁸⁸ Indeed, they must be interpreted in light of the factors mentioned by Botha. This was made explicitly clear in the case of *S v Zuma* where Kentridge AJ held that:

We must heed Lord Wilberforce’s reminder that even a constitution is a legal instrument, the language of which must be respected. If the language used by the lawgiver is ignored in favour of a general resort to

⁸⁴ Devenish *Interpretation of Statutes* 35.

⁸⁵ Devenish *Interpretation of Statutes* 35.

⁸⁶ Botha *Statutory Interpretation: An introduction for students* 51, Carpenter 1999 *THRHR* 628.

⁸⁷ Botha *Statutory Interpretation: An introduction for students* 51.

⁸⁸ Botha *Statutory Interpretation: An introduction for students* 50.

‘values’ the result is not interpretation but divination. ... I would say that a constitution embodying fundamental principles should as far as its language permits be given a broad construction.⁸⁹

It must be noted that, although this judgment dealt with interpretation of the Constitution, it is a valid statement in line with how to proceed when adopting the purposive approach. In other words the purposive approach must not be construed as an approach that places no importance on the language used; on the contrary the language used is fundamental to the final result when considered together with the factors outlined by Botha. The purposive approach could be described as a union of contextual factors, the purpose or object of the statute in question and the language used in order to attain that object. It should be noted that the ordinary version of the concept of contextualism appears to be an ally of the purposive approach.⁹⁰ It is referred to as the ‘ordinary’ version because there are versions of this concept which have as their purpose the enrichment of literalism. These versions will not be discussed. A classic dictum with respect to the contextual approach was postulated by Rumpff CJ in the case of *SIR v Brey* where he held that:

For purposes of ascertaining the meaning of words in a legal document like a contract, a will or a statute, a Court never looks at the words in stark isolation. It looks at the words in their setting, at the context in which the words are used and at the purpose for which the words are intended.⁹¹

This passage accords with Botha’s explanation of the purposive approach outlined above and is, therefore, evidence of the alliance between contextualism and purposivism. It is submitted that the purposive approach is, therefore, inclusive of the ordinary concept of contextualism.

The purposive approach to statutory interpretation demands that the purpose or objective of the provision or statute first be determined. Once the purpose of the provision or statute in question is conclusively determined an interpreter must compare the language used in the statute to the purpose or object. If the purpose and the language are in accordance with each other, the interpreter’s job is at an end. Where, however, a

⁸⁹ 1995 (2) SA 642 (CC) para 17, Currie and de Waal *The Bill of Rights Handbook* 147.

⁹⁰ du Plessis *Re-Interpretation of Statutes* 111.

⁹¹ 1980 (1) SA 472 (A) 478A-B, du Plessis *Re-Interpretation of Statutes* 111.

variance between the purpose and the language is evident an interpreter must endeavour to place a meaning on the words in question that best accords with the purpose of the provision. The words in question must, however, be competent of bearing such a meaning.⁹² In other words an appropriate meaning is to be placed on the words that accords, as far as the “language permits,”⁹³ with the purpose. This approach has been met with approval by academics and judicial officers alike.⁹⁴ It has, inevitably, been subject, also, to criticism from various quarters. These criticisms will be returned to after a brief exposition of the teleological approach to interpretation. An understanding of this approach is required in order to comprehend the criticisms of the purposive approach.

2.3.1 The teleological (or value coherent) theory⁹⁵

This is not a separate theory of statutory interpretation. It should be viewed as an extension of purposivism or as a wide form of purposivism. It goes beyond merely seeking the purpose or object of an enactment in that it aspires to the “scheme of values” on which the entire legal system is based.⁹⁶ In other words the approach is premised not only on the individual statute or piece of legislation in question but, rather, on the values “informing the legal and constitutional orders in their totality.”⁹⁷ Devenish states that this approach “has as its fundamental premise the realization of justice for the individual.”⁹⁸ The attainment of justice must, of necessity, be linked to morality based on a set of values. This is why it is called the value-coherent approach by some commentators. This approach, therefore, goes hand-in-hand with the theory of natural law which, unlike positivism referred to above, does not separate law and morality. In fact, natural law theorists do not even consider an unjust law to be a law.⁹⁹ Justice, morality and equity are critical concepts that must be practically adhered to in order for a proper application

⁹² Goldswain 2008 *Meditari Accountancy Research* 117.

⁹³ *S v Zuma* para 17.

⁹⁴ Goldswain 2008 *Meditari Accountancy Research* 119.

⁹⁵ Devenish *Interpretation of Statutes* 39.

⁹⁶ E Murenik “Administrative Law in South Africa” (1986) 103 *SALJ* 615 at 624, du Plessis *Re-Interpretation of Statutes* 119.

⁹⁷ du Plessis *Re-Interpretation of Statutes* 119, Carpenter 1999 *THRHR* 633.

⁹⁸ Devenish *Interpretation of Statutes* 44.

⁹⁹ D Johnson *et al Jurisprudence: A South African Perspective* (2001) 100.

of this approach. It is submitted that the same procedure would be followed in this approach as is adopted for the purposive approach outlined above. The only difference would be the first step where instead of merely determining the purpose or object of a particular statute, a court would also determine the values or aspirations on which the legislation and the legal order in question are based. The procedure would, thereafter, accord with the purposive approach to interpretation outlined above.

It has commonly been assumed that the school of literalism was the primary or first theory of statutory interpretation.¹⁰⁰ This is a fallacy both in terms of English common law and Roman-Dutch law. The courts had no choice but to follow a purposive approach in England during the fourteenth century and onwards due to the irregularity with which Parliament convened.¹⁰¹ In other words a defect in the language of a statute would be left unattended to for an unreasonable amount of time unless some form of judicial activism was employed. The role of the judiciary as a point of divergence between literalism and purposivism must be emphasised at this stage. The courts, out of “practical necessity”¹⁰² had to construe enactments, therefore, in a purposive fashion. Du Plessis comments that literalism was actually a consequence of the introduction, in the nineteenth century, of parliamentary supremacy¹⁰³ and also the increased acceptance of the theory of positivism. A traditional application of Roman-Dutch law subscribed to a teleological approach or extended form of purposivism. This is made abundantly clear by the following passage by Wessels in his work on the history of Roman-Dutch law:

Voet feels ... that law is a branch of morals and that the judge in interpreting the law must always bear in mind the fact that the ultimate end and object of all law is to regulate relations of individuals according to that sense of right and wrong that prevails in the community ... Equity then is necessary to interpret the meaning of the law-giver, and to apply the law to the vast variety of cases that present themselves.¹⁰⁴

¹⁰⁰ du Plessis *Re-Interpretation of Statutes* 97.

¹⁰¹ du Plessis *Re-Interpretation of Statutes* 97.

¹⁰² du Plessis *Re-Interpretation of Statutes* 97.

¹⁰³ du Plessis *Re-Interpretation of Statutes* 97.

¹⁰⁴ JW Wessels *The History of the Roman-Dutch Law* (1908) 327 quoted in Devenish *Interpretation of Statutes* 42.

It should be noted that Voet is generally regarded as one of the most influential Roman-Dutch authorities. This passage represents irrefutable evidence of the Roman-Dutch scholars' value-coherent or teleological approach to statutory interpretation. While the phrase 'value-coherent' is not specifically referred to, references to 'equity' and the phrase 'sense of right and wrong' are sufficient indicators of the value-driven approach that was employed. This approach, it is submitted, is in harmony with the way in which constitutional provisions are now interpreted. Constitutional interpretation will be briefly alluded to below. But for the infamous and ultimately incorrect judgment delivered by De Villiers CJ in the 1875 case of *De Villiers v Cape Divisional Council* where the literal approach was adopted from English law,¹⁰⁵ South Africa may never have had to apply the, somewhat, illogical literalist approach.¹⁰⁶ It is palpably possible that it may, however, have found its way into our law via another path. This is suggested in light of the influence that English law has generally had on our legal system. The next sub-section will briefly outline some of the controversies and criticisms of the both the purposive approach and the teleological approach.

2.3.2 Criticisms of both the purposive approach and the teleological approach

The purposive approach has largely been subject to academic attack when compared to the value-centred teleological approach. Proponents of the teleological approach have described the purposive approach as limited due to the fact that it is only concerned with the purpose of the individual statute in question. It does not aspire to a higher order of values inherent in the legal system.¹⁰⁷ This purported insular nature of the purposive approach, with reference to Apartheid legislation, is summed up concisely by Mureinik where he stated that:

If the policy of a statute is iniquitous, a purposive interpretation may well foster iniquity.¹⁰⁸

¹⁰⁵ Devenish *Interpretation of Statutes* 27, (1875) 5 Buch 50 at 65.

¹⁰⁶ Goldswain 2008 *Meditari Accountancy Research* 114.

¹⁰⁷ Mureinik 1986 *SALJ* 624.

¹⁰⁸ Mureinik 1986 *SALJ* 624.

The purposive approach has also been subject to criticism on the basis that a statute may, according to different interpreters, serve different purposes. This is in light of the practical reality of legislative compromise.¹⁰⁹ This smacks of similar criticisms the intentionalist approach has received. It is, however, submitted that this criticism does not take full account of the fact that purposive interpretation is an objective exercise undertaken in light of the statute as a whole. It is suggested that legislative compromise – more often than not - involves the wording or inclusion of specific provisions. In other words compromise is usually with respect to a particular provision – not the statute as a whole. Even where legislative compromise has occurred it is suggested that it is still very possible to attain the single holistic purpose behind a particular statute.

The only criticism that is consistently levelled at the teleological approach is that it breeds uncertainty or unpredictability.¹¹⁰ This is an understandable criticism in light of its pursuit of higher values or morality. Individual judges may well have different value-systems or different notions of justice.¹¹¹ This criticism, it is submitted, is tempered by the “inherent indeterminacy”¹¹² of language. In other words a literal approach provides no more certainty than a teleological approach to interpretation. This was succinctly articulated by De Villiers JA where it was stated that:

... it is dangerous to speculate as to the intention of the legislature and what seems an absurdity to one man does not seem absurd to another.¹¹³

It should be noted that ‘the intention of the legislature’ was essentially equivalent to a literal reading of the provision in question at the time this judgment was delivered. Whilst it may be conceded that both the literal approach and the teleological approach lend themselves to a degree of uncertainty; it is submitted that a teleological approach will ensure a more just or equitable outcome. The advent of the constitutional era and its

¹⁰⁹ Carpenter 1999 *THRHR* 632.

¹¹⁰ Devenish *Interpretation of Statutes* 47.

¹¹¹ Devenish *Interpretation of Statutes* 47.

¹¹² Carpenter 1999 *THRHR* 627.

¹¹³ *Shaler v The Master* 1936 AD 136 at 143.

effect on statutory interpretation will be briefly dealt with whereafter a conclusion will be offered.

2.3.3 The advent of the constitutional era and its effect on statutory interpretation

The advent of the Interim Constitution brought a drastic change in the South African legal order with far reaching effects throughout the legal system. The subject of statutory interpretation has not been immune to such effects. South Africa was transformed from a system of parliamentary supremacy to one of constitutional supremacy.¹¹⁴ Earlier it was stated that parliamentary supremacy is associated with the doctrine of positivism which, inevitably, results in an application of the literal approach to statutory interpretation.¹¹⁵ Constitutional supremacy is, however, premised on the fact that all legislation must be read and interpreted in light of constitutionally enshrined values.¹¹⁶ A state, such as South Africa, based on constitutional supremacy is, therefore, compelled to implement a value-based approach to interpretation. These values are derived from the constitution. Such an approach accords with the teleological approach to statutory interpretation which has, as its premise, adherence to a higher set of values. The constitution is the supreme law of the land¹¹⁷ and is, essentially, a codification of this set of values. It follows – quite obviously - that the political changes in this country have had a direct impact on the subject of statutory interpretation. How deep an impact this change has had is, however, yet to be fully determined. Currie and de Waal are of the opinion that a purposive approach is required and, indeed, applied now when interpreting constitutional provisions. The way in which they describe it, however, appears to be more akin to the teleological or value-coherent method of interpretation.¹¹⁸ The warning issued by Carpenter with respect to labelling should, however, be considered at this point. It can be quite firmly stated that a liberal form of purposivism that is similar to the teleological approach is applied with respect to constitutional provisions. Whether, however, such an

¹¹⁴ Currie and de Waal *The Bill of Rights Handbook* 2.

¹¹⁵ Devenish *Interpretation of Statutes* 32.

¹¹⁶ Currie and de Waal *The Bill of Rights Handbook* 9.

¹¹⁷ Constitution of South Africa, 1996.

¹¹⁸ Currie and de Waal *The Bill of Rights Handbook* 149.

approach is consistently applied with respect to fiscal legislation or other legislation is still debatable.¹¹⁹

2.4 Conclusion

It is interesting to note that while Botha is of the opinion that most of our courts still adhere to the literal theory of interpretation, Goldswain, on the contrary, believes that the purposive approach is now dominant.¹²⁰ This is a remarkable divergence of opinion and is illustrative of the confused state of the subject of statutory interpretation. Not only are the principles of the different theories or approaches questioned; the approach that the courts have actually taken is not even agreed upon. This points to a fundamental divergence of what, for example, the theory of literalism or purposivism, even is. The above discussion has highlighted the so-called main approaches to statutory interpretation. Some of the more common criticisms of each approach have also been discussed. The literal approach has been overwhelmingly shown to be fraught with misconceptions about the nature of language, the time frame within which statutes operate as well as the role of the judiciary. The concept of ‘the intention of the legislature’ was extensively criticised on the basis of its artificiality. It was, however, conceded that this artificiality may well be its only defensible feature. It is far more meritorious a concept when considered as a legal fiction because it becomes more closely associated with the purposive approach. The purposive approach is more objective and fluid and recognises that the purpose of legislation must be construed in an ever-changing and evolving society. It does not deny the continuing time frame in which legislation operates. This is considered to be one of the major downfalls of intentionalism and literalism. The American case of *Barnett* was referred to in this regard. The purposive approach was, however, not spared criticism. It has been suggested that since the purposive approach only investigates the purpose of the particular statute in question, it may perpetuate iniquity where iniquity is the purpose of a statute. In other words a

¹¹⁹ Goldswain 2008 *Meditari Accountancy Research* 114, Botha *Statutory Interpretation: An introduction for students* 50.

¹²⁰ Goldswain 2008 *Meditari Accountancy Research* 114, Botha *Statutory Interpretation: An introduction for students* 50.

purposive approach, unlike the teleological approach, does not concern itself with a higher set of values. The teleological approach is associated with the quest for justice and morality. It is, essentially, a wider form of purposivism in that it takes the values of the entire legal order into consideration. It has, inevitably, been criticised for leading to legal uncertainty. This criticism was challenged on the basis that the literal approach to interpretation leads to no more certainty due to the fact that what may appear absurd to one person may not appear to be “absurd to another.”¹²¹

There is no correct theory of interpretation. The purposive or teleological approaches do, however, contain a measure of equity and justice and are, therefore, preferable as opposed to the others. It is beyond question that constitutional provisions are interpreted in a purposive or teleological fashion. It is still debated, and, essentially unknown, whether such an approach has filtered through to ordinary statutory interpretation. This thesis, as was stated in the introduction, will outline and discuss some of Watermeyer’s contributions to South African tax jurisprudence. The part of his career which will be focused on spanned from 1926 until 1948. It is with confidence that it can be stated that the literal approach – throughout this period – was firmly entrenched in South African law. Despite this seemingly entrenched approach, it will be shown in the subsequent two chapters that Watermeyer was, by no means, a slave to it. Whilst he never expressly referred to which theory of interpretation he subscribed to, it is evident, on a close examination of some of his judgments, that a purposive-oriented approach was, at times, being employed. His practical contributions together with his interpretative contributions will, therefore, be the focus of the next two chapters. It will serve the reader well to bear in mind the above discussion of theoretical approaches to statutory interpretation for the remainder of this thesis.

¹²¹ *Shaler v The Master* 1936 AD 136 at 143.

CHAPTER THREE: WATERMEYER'S CONTRIBUTIONS BEFORE HIS RISE TO CHIEF JUSTICE

3.1 Introduction

Watermeyer has been described as a “giant of the South African judiciary.”¹²² This chapter together with the subsequent chapter will demonstrate why he is so deserving of this description. It must be acknowledged that Watermeyer made substantial contributions to branches of law other than tax law. The scope of this thesis is limited, however, to his main contributions to South African tax law. It is interesting to note that tribute writers at the time of his departure from the judiciary did not appear to appreciate the magnitude of his contributions with respect to taxation matters. His contributions in other commercial matters as well as delictual matters were, however, celebrated.¹²³ This is possibly due to the fact that taxation was not regarded as particularly important at the time. A chronological approach to his contributions with respect to tax law will be adopted in order for his development as judge in this branch of law to be appreciated. This chapter will consist of an analysis of *Lategan v CIR*,¹²⁴ *Port Elizabeth Electric Tramway Co v CIR*¹²⁵ and *Commissioner of Customs and Excise v Randles Brothers and Hudson*.¹²⁶ Before an analysis of these cases is undertaken it is important to note that gross income is currently defined in section one of the Act as:

- (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 or deemed to be within the Republic,

¹²² L Wright “Edward Frederick Watermeyer” (2009) 23 *Tax Planning* 93 at 93.

¹²³ Hahlo and Mckerron (ed) 1950 *SALJ* 332-336.

¹²⁴ 1926 CPD 203.

¹²⁵ 8 SATC 13.

¹²⁶ 33 SATC 48.

during such year or period of assessment, excluding receipts or accruals of a capital nature, but including, without in any way limiting the scope of this definition, such amounts (whether of a capital nature or not) so received or accrued as are described hereunder, . . .¹²⁷

There are a number of special inclusions listed under the general definition of gross income. These inclusions are, for the most part, not relevant for the purposes of this thesis. The ‘general deduction formula’, which consists of the preamble to section 11 and section 11 (a), read with section 23 (g)¹²⁸, is also important for the purposes of both this chapter and the following one. The preamble to section 11 and section 11 (a) provide for expenses which may be deducted from the income of a taxpayer and reads as follows:

For the purposes 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 person so derived –

- a) expenditure and losses actually incurred in the production of income, provided such expenditure and losses are not of a capital nature. . . .¹²⁹

Once again, there are a number of specific inclusions under section 11. Such inclusions will, however, only be referred to and quoted if and where necessary. Section 11 (a) is usually referred to as the positive aspect of the general deduction formula in that it provides for what may be deducted. Section 23 (g), on the other hand, is generally regarded as the negative aspect of the general deduction formula because it provides for what may not be deducted.¹³⁰ It reads as follows:

No deductions shall in any case be made in respect of the following matters, namely –

- g) any moneys, claimed as a deduction from income derived from trade, to the extent to which such moneys were not laid out or expended for the purposes of trade.¹³¹

The general definition of gross income, section 11 (a) and section 23 (g) are vital to this thesis and reference thereto will, therefore, be made throughout the remainder of this thesis. The facts of each of the three cases listed above will be outlined whereafter an

¹²⁷ Act 58 of 1962.

¹²⁸ De Koker and Williams *Silke on South African Income Tax* para 7.3.

¹²⁹ Act 58 of 1962.

¹³⁰ De Koker and Williams *Silke on South African Income Tax* para 7.3.

¹³¹ Act 58 of 1962.

analysis of each judgment will be embarked upon. The analysis will focus on a combination of the interpretative style adopted, the judicial reasoning or logic employed, as well as the extent to which it is easily understandable to the reader. It must be noted, however, that Watermeyer's approach to interpretation is, at times, difficult to conclusively define. This statement is not peculiar to Watermeyer and is, in fact, common to most judgments in all branches of law. The practical contribution of each judgment will also be established with reference to recent case law and publications. Before these cases are discussed and analysed it is first necessary to make brief reference to the prevailing interpretative approach to fiscal legislation during Watermeyer's tenure as a judge. The first judgment that will be analysed, thereafter, is the *Lategan* decision.

3.2 Approach to the interpretation of fiscal legislation before 1975

This section is not in any way intended to be a restatement of the previous chapter. It is aimed at highlighting the fact that the approach to interpreting fiscal legislation during Watermeyer's twenty-two year tenor was considered to be different from the approach followed when interpreting regular legislation.¹³² It was held in the English case of *Cape Brandy Syndicate v IRC*¹³³ that:

...in a taxing Act one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used.¹³⁴

Goldswain, quite correctly, states that the decision handed down in the case of *CIR v Simpson*¹³⁵ adopted the above statement with respect to fiscal interpretation.¹³⁶ If one were to take a cursory glance at the case it may appear as though Watermeyer, himself, adopted the above statement. On a closer reading of the case it will very quickly become clear that this was not, however, the case. Watermeyer delivered a separate judgment

¹³² Goldswain 2008 *Meditari Accountancy Research* 109.

¹³³ 1921 (1) KB 64

¹³⁴ *Cape Brandy Syndicate v IRC* 71.

¹³⁵ 16 SATC 268.

¹³⁶ Goldswain 2008 *Meditari Accountancy Research* 109.

with which Schreiner JA concurred. Centlivres JA, together with a concurring Van den Heever JA, adopted the above quoted statement of the law regarding fiscal interpretation.¹³⁷ It is quite apparent that Watermeyer, in his judgment, did not adhere to the strict and literal rule of interpretation. The relevancy of this particular judgment lies in its illustrative nature. It is illustrative of Watermeyer's purposive-oriented approach at a time when a very strict form of literalism was dominant – especially with respect to tax legislation. Evidence of his purpose-oriented approach is gathered from his reference to surrounding contextual factors such as the history of the provision¹³⁸ and other sections of the Act.¹³⁹ He also refers specifically to the object of the Act as a whole.¹⁴⁰ The word 'object' is synonymous with the word 'purpose.' He, essentially, therefore, established the purpose of the provision in question with reference to contextual factors as well as the purpose of the Act as a whole. This has a distinctly purposive ring to it – especially when it is remembered that contextualism was shown to be an ally of purposivism in the previous chapter. Even though *Simpson* has been cited for adopting the statement of law issued in the *Cape Brandy* decision; Watermeyer did not, himself, adopt it. This issue must not be confused as the remainder of this thesis makes quite regular reference to his purposive, or at least, non-literal style of interpretation.

The *Cape Brandy* approach to fiscal legislation was only finally discarded in the case of *Glen Anil Development Corporation v SIR*¹⁴¹ where Botha JA stated that:

... there seems little reason why the interpretation of fiscal legislation should be subjected to special treatment which is not applicable in the interpretation of other legislation.¹⁴²

Fiscal legislation is, on the basis of this statement, interpreted in the same fashion as other legislation. Watermeyer – unlike modern day judges – had to navigate his way, with respect to fiscal interpretation, through a minefield of primitive literalism and stark adherence to the letter of the law. This must be borne in mind throughout this thesis and

¹³⁷ *CIR v Simpson* 285.

¹³⁸ *CIR v Simpson* 281.

¹³⁹ *CIR v Simpson* 283.

¹⁴⁰ *CIR v Simpson* 282.

¹⁴¹ 37 SATC 319.

¹⁴² *Glen Anil Development Corporation v SIR* 334.

may, possibly, explain why the particular approach adopted in some of the analysed cases is not particularly clear.

3.3. The impact of *Lategan v CIR* on the definition of gross income: A general perspective

The appellant in *Lategan v CIR* was a wine farmer. He sold wine for the sum of approximately six thousand pounds in May 1920. Only three thousand five hundred of this amount was payable in the year of assessment ending on the 30 June 1920. The balance was to be paid in instalments between July and September. The issue to be determined was whether the whole amount of six thousand pounds was to be included in the taxpayer's gross income for the year of assessment in question.¹⁴³ The issue was, essentially, based on an interpretation of the word 'amount' as well as an interpretation of the phrase 'accrued to'. The taxpayer's contention was that the instalment moneys should not have been assessed as they had not yet been received and neither had they accrued. It should be noted with respect to the definition of gross income as it then stood that the words "in cash or otherwise" did not follow the word "amount" as they do now.¹⁴⁴

Watermeyer, in a particularly concise and comprehensible judgment, disposed of the appellant's contention in an exceptionally logical fashion. It was held that the word 'amount,' although generally associated with a monetary amount, needed to be given a wide interpretation in order to accord with 'the intention of the legislature.'¹⁴⁵ The reason for such a need was due to the fact that a taxpayer, in order to avoid tax liability, could merely arrange to receive payment in something other than money.¹⁴⁶ This situation was regarded (and still would be) as untenable by Watermeyer. Such an interpretation ensured that rights to payment such as the one the appellant had would be subject to assessment. In other words the right to the balance of the payments between

¹⁴³ *Lategan v CIR* 207.

¹⁴⁴ *Lategan v CIR* 207.

¹⁴⁵ *Lategan v CIR* 208.

¹⁴⁶ *Lategan v CIR* 208.

July and September was an ‘amount’ because such a right had a money value. That right could theoretically have been disposed of for a money value.

Watermeyer’s approach to the interpretation of the word ‘amount’ was, essentially, purposive in nature. It must be noted that while Watermeyer specifically referred to legislative intention, he did so, it is submitted, by using ‘the intention of the legislature’ as a legal fiction. It will be remembered from chapter two that when ‘the intention of the legislature’ is regarded as a legal fiction the approach in question is closely related to a purposive approach to statutory interpretation. This is because it becomes more objective in nature. Evidence of the adoption of a purposive-oriented approach by Watermeyer in this case is his reference to contextual factors such as other provisions in the Act.¹⁴⁷ He referred to two other provisions which accorded with the wider interpretation he sought to place on the word ‘amount.’ Contextualism, as mentioned above, was shown to be an ally of the purposive approach in chapter two. The purpose of the provision in question was determined with reference to these contextual factors. Once the purpose of the Act and, more specifically, the provision in question was determined, it was held that a wide interpretation of the word ‘amount’ was required in order to give effect to that purpose. This is not dissimilar to the method that should be employed when applying the purposive approach as summarised in chapter two. The borders between the different approaches to interpretation have been shown to be, somewhat, blurred and misunderstood. While it is conceded that the approach with respect to the word ‘amount’ was not based on a precise purposive formula; the outcome of the case as well as the process with which such an outcome was achieved lends strong support to the submission that a purposive-oriented approach was, indeed, adopted. Moreover, preciseness is not a concept associated with the subject of statutory interpretation. On a careful reading of the judgment with respect to the interpretation of the word ‘amount’ it is very evident that a purposive-oriented approach was adopted. A literal approach may well have resulted in the word ‘amount’ being interpreted in a narrow and illogical fashion. The logical and clear nature of Watermeyer’s conclusion in this regard was recently given credence by Wright where she stated that:

¹⁴⁷*Lategan v CIR* 209.

It is so logical that it is incomprehensible to think that a taxpayer may look at this issue in another way, but for his guidance.¹⁴⁸

The phrase ‘accrued to or in favour of any person’ was interpreted as simply meaning ‘to which he has become entitled.’¹⁴⁹ The judgment with respect to the determination of this interpretation contains no evidence of the approach to interpretation that was employed. The appellant attempted to argue that in order for an amount to have accrued, it must be payable and since the instalments were not yet payable, no amount should have been included in his gross income. In rejecting this argument Watermeyer did, however, recognise the difficulty involved in including in the taxpayer’s gross income the cash amount of the debt payable due to the fact that it was a right to payment in the future. He held in this regard that:

It might be difficult to hold that the *cash amount* of the debt has accrued to the taxpayer in the year of assessment. He has not become entitled to a right to claim payment of the debt in the year of assessment, but he has acquired a right to claim payment of the debt in future. This right has vested in him, has accrued to him in the year of assessment, and it is a valuable right which he could turn into money if he wished to do so. According to what has been stated above, the value of this right must, in my opinion, be included in the taxpayer’s gross income for taxation purposes (original emphasis).¹⁵⁰

The fundamental flaw with the taxpayer’s argument, it is submitted, was that a debt does not have to be payable to have a money value. In other words the taxpayer’s right to future payment was a valuable right which had conclusively accrued and, therefore, had to be valued and included in gross income. It is submitted that the comment by Wright quoted above with respect to the interpretation of the word ‘amount’ is equally applicable to the interpretation of ‘accrued to.’ This judgment was delivered in the Cape Provincial Division and, as such, did not create binding precedent nationally. It was formally and finally adopted by the Appellate Division in the case of *CIR v People’s Stores (Walvis*

¹⁴⁸ Wright 2009 *Tax Planning* 93-94.

¹⁴⁹ *Lategan v CIR* 209.

¹⁵⁰ *Lategan v CIR* 209-210.

Bay)¹⁵¹ in 1990. The expression “formally adopted” is used because according to Hefer JA “the so-called *Lategan* principle” had been accepted by the fiscal authorities as a correct reflection of the law years previous to his judgment.¹⁵²

The *People’s Stores* case involved a clothing and household textiles retailer. The majority of its credit sales were undertaken according to its ‘6-months-to-pay’ policy. This policy stipulated that the customer was allowed to pay the purchase price in six equal instalments.¹⁵³ The Commissioner included amounts that had not yet become payable in the taxpayer’s gross income. In other words the entire purchase price regardless of the outstanding amount payable according to the policy was included in gross income. The facts are analogous to those that were present in the *Lategan* case. The two questions submitted to the Special Court were as follows:

- (a) Ought the value of the instalments not yet payable nor paid to have been included in the taxpayer’s gross income?
- (b) If so, at what value ought those instalments to have been included in the gross income? Ought it to have been done at face value or at the value to the taxpayer or at the market value or at some other value?¹⁵⁴

After setting out the facts as well as the legal questions that required addressing Hefer JA immediately quoted a significant part of Watermeyer’s *Lategan* decision with respect to the meaning to be placed on the word ‘amount’ in the definition of gross income. With respect to the provision in question it was noted that there was no material difference between how it was worded at the time of *Lategan* and its current wording. Hefer JA adopted the following dictum from the *Lategan* decision as a sound and inarguable reflection of the law:

In my opinion, the word “amount” must be given a wider meaning, and must include not only money, but the value of every form of property earned by the taxpayer, whether corporeal or incorporeal, which has a money value ... including debts and rights of action.¹⁵⁵

¹⁵¹ 52 SATC 9.

¹⁵² *CIR v People’s Stores (Walvis Bay)* 20.

¹⁵³ *CIR v People’s Stores (Walvis Bay)* 18.

¹⁵⁴ *CIR v People’s Stores (Walvis Bay)* 18.

According to Hefer JA this proposition was “obviously correct.”¹⁵⁶ Since this was correct it followed that the right to receive future payments constituted an amount. It thereafter had to be determined whether the meaning ascribed to ‘accrued to’ by Watermeyer was also correct. In this regard Hefer JA quoted the following passage from Watermeyer’s judgment which stated that:

... he has acquired a right to claim payment of the debt in the future. This right has vested in him, has accrued to him in the year of assessment, and it is a valuable right which he could turn into money if he wishes to do so.¹⁵⁷

Hefer JA in a straightforward and deliberate manner held that there was “no logical answer to this reasoning.”¹⁵⁸ In other words the logic employed is undefeatable. This is a significant feat for a judgment that was delivered some sixty-four years earlier. Hefer JA accepted both the contested interpretations in the definition of gross income in the *Lategan* case in an utterly unqualified manner. *Lategan*, as adopted by *People’s Stores (Walvis Bay)* remains the uncontested authority with respect to the interpretation of the word ‘amount’ and the phrase ‘accrued to.’ It should be noted that the words ‘in cash or otherwise’ were inserted by the tax authorities subsequent to the *Lategan* decision, probably, in order to quell any future controversy involving the interpretation of the word ‘amount.’ Their inclusion, it is submitted, was a direct result of the *Lategan* decision.

3.3.1 Briefly *Brummeria*: *Lategan*’s durability

The recent controversial case of *C:SARS v Brummeria Renaissance*,¹⁵⁹ which involved the granting of interest free loans, referred authoritatively to the *Lategan* decision as adopted by the Appellate Division in the *People’s Stores* case. While a discussion of the case is beyond the scope of this thesis it is interesting to note that the interpretations

¹⁵⁵ *CIR v People’s Stores (Walvis Bay)* 21, *Lategan v CIR* 209.

¹⁵⁶ *CIR v People’s Stores (Walvis Bay)* 21.

¹⁵⁷ *CIR v People’s Stores (Walvis Bay)* 21, *Lategan v CIR* 210.

¹⁵⁸ *CIR v People’s Stores (Walvis Bay)* 21.

¹⁵⁹ 69 SATC 205.

adopted by the same court in the *People's Stores* case were not queried. The respondents – arguing that the value of the interest free loans should not be assessed – did not question Watermeyer's dictum as adopted by Hefer JA in *People's Stores*. They, instead, attempted to rely on the argument that the interest free loans were not “capable of being valued in money.”¹⁶⁰ This was the only qualification Watermeyer attached to his wide interpretation of the word ‘amount.’¹⁶¹ In other words if a money value cannot be placed on the ‘amount’ in question, it cannot be assessed. The respondent's argument was, however, controversially disposed of by the Court. It, essentially, stated, bearing in mind modern commercial reality, that the right to hold and utilise loan capital interest free was a valuable right which did have a money value.¹⁶² It is, perhaps, necessary at this point to, once again, emphasise that the *Lategan* case was decided in 1926. It is highly improbable that a scheme such as the one employed by the respondents in *Brummeria* would have been considered or even conceived of by the commercial world in 1926. Watermeyer's interpretations were, in spite of this, still applicable to the scheme. What makes these interpretations even more admirable, therefore, is their durability and diversity of applicability. In other words his interpretations are still, and will continue to be, applicable in an ever-changing and evolving society. This point, with respect to other decisions, will be returned to.

3.3.2 Conclusion and summary of Watermeyer's *Lategan* contributions

The *Lategan* principle is fundamental to the Act as a whole. A taxpayer's gross income must obviously be established before other provisions are considered. The interpretation placed on the phrase ‘accrued to’ has withstood the test of time and is now recognised as entrenched law. The wide interpretation placed on the word ‘amount’ did not have to withstand such a test as it was, almost, immediately given legislative recognition when the words ‘in cash or otherwise’ were inserted by the Legislature. This definition has remained unaltered ever since. It is interesting that both Hefer JA, with respect to the *Peoples Stores* case, and Wright made reference to the undefeatable logic employed by

¹⁶⁰ *C:SARS v Brummeria Renaissance* para 13.

¹⁶¹ *Lategan v CIR* 209.

¹⁶² *C:SARS v Brummeria Renaissance* para 12.

Watermeyer. All the primary taxation textbooks used by South African students refer to the *Lategan* decision when discussing the general definition of gross income.¹⁶³ This is no surprise due to its entrenched law status. The style of interpretation adopted with respect to the word ‘amount’ was shown to be a purposive-oriented style or method. This was, it is submitted, a remarkable achievement given the climate of statutory interpretation at the time – especially with respect to fiscal legislation. The approach, as mentioned above, to fiscal legislation at the time was strictly literal – possibly, even, primitively literal. Despite the prevailing approach, Watermeyer was able to apply a more purposive and, thus, progressive method of interpretation that resulted in legislative recognition. It was stated above that there was insufficient evidence to determine what approach had been adopted with respect to the phrase ‘accrued to.’ What is, however, clear is that whatever approach may have been used, it was a pragmatic or common-sense approach that resulted in an enduring interpretation. Another striking feature of Watermeyer’s interpretations, discovered with reference to the *Brummeria* decision, is their applicability to novel situations. In other words commercial schemes that would probably not have been conceived of at the time of Watermeyer’s interpretations are still governed by such interpretations. This point will be developed with reference to other decisions. The next case to be discussed dealt with the interpretation of section 11 (a) and the so-called general deduction formula which stipulates what expenses may be deducted from the income of a taxpayer.

3.4 Section 11 (a) in the spotlight: *Port Elizabeth Electric Tramway Co v CIR*

The appellant in the case of *Port Elizabeth Electric Tramway Co v CIR* operated a tramway company. During the year in question one of its tramway drivers lost control of a tram-car when descending a sharp incline. The driver subsequently died as a result of the accident and the appellant was compelled to pay compensation in terms of the

¹⁶³ De Koker and Williams *Silke on South African Income Tax* para 2.7, E Muller “Gross income” in M Stiglingh (ed) *Silke: South African Income Tax 2009* (2008) 13, Huxham and P Haupt *Notes on South African Income Tax* 27 ed (2008) 15, RC Williams *Income Tax in South Africa Cases and Materials* 2 ed (2005) 87.

Workmen's Compensation Act.¹⁶⁴ The appellant was forced to pay damages of approximately six hundred pounds. It spent approximately seven hundred pounds on legal fees in resisting this claim. The appellant attempted to deduct both these amounts from its taxable income. This attempt was, however, blocked by the Commissioner who contended that such expenditure did not meet the requirements of the general deduction formula which consisted, at the time, of section 11(2)(a) and section 13(b).¹⁶⁵ It should be noted that section 11(2)(a) was, materially, the same as the current section 11(a). Section 11(a) was quoted in the introduction and should be re-read in order to understand the following analysis. Section 13(b) was section 23 (g)'s predecessor. It must be noted, however, that there has been a substantial change in wording. Section 13(b) provided that:

No deductions shall, as regards income derived from any trade, be made in respect of any of the following matters: -

- (b) any moneys not wholly or exclusively laid out or expended for the purposes of trade.¹⁶⁶

This is significantly different to the current section 23(g) which explicitly allows for an apportionment of expenditure.¹⁶⁷ This change in wording has, however, had little effect on the durability of the judgment delivered in this case. It was noted above that section 23(g) provides the negative aspect of the general deduction formula while section 11(a) the positive. This description, which has become commonly used, was coined by Watermeyer AJP (as he then was) in this case.¹⁶⁸ This was, however, a minor contribution when compared to others offered in the same judgment.

Watermeyer's description of which expenditure may be deducted has been quoted by a number of subsequent courts, academics and textbooks alike. Watermeyer stated, after a brief introduction and outlining of the relevant provisions, that:

¹⁶⁴ Act 8 of 1923.

¹⁶⁵ *Port Elizabeth Electric Tramway Co v CIR* 13.

¹⁶⁶ Act 40 of 1925.

¹⁶⁷ *Huxham and Haupt South African Income Tax* 101.

¹⁶⁸ *Port Elizabeth Electric Tramway Co v CIR* 14.

As a rough generalisation it may be said that, save in the case of a loan capital, income is produced by a series of operations and transactions entered into for the purpose of manufacturing or acquiring a saleable product and thereafter selling it or by rendering services for which payment is received. In the course of such operations and transactions, expenditure and losses may be incurred and these are the expenditure and losses referred to in the section.¹⁶⁹

After noting that the word ‘losses’ in section 11(a) was not relevant for current purposes, he went on to examine, more closely, the issue of expenditure. It was noted that expenditure must be ‘actually incurred’ in order to be deductible. The fact that the word ‘actually’ was used by the Legislature as opposed to the word ‘necessarily’ was discussed by Watermeyer. He specifically drew attention to the fact that the word ‘actually’ is of a wider ambit.¹⁷⁰ Watermeyer then used the following illustrative example in explaining the application of the word ‘actually’ as opposed to ‘necessarily’:

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.¹⁷¹

This example was the first of many illustrative examples to come. Examples such as this provide a link between legal or technical interpretation and the practical application thereof. They aid in the understanding of the judgment due to the fact that a practical illustration is created in the mind of the reader. It was then noted by Watermeyer that ‘actually incurred’ is not equivalent to ‘actually paid.’ Once again an illustrative example was employed in order for his contention to be fully appreciated:

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.¹⁷²

This example and explanation of the meaning of ‘actually incurred’ is consistent with the principle laid down in the *Lategan* decision with respect to the meaning of ‘accrued to.’

¹⁶⁹ *Port Elizabeth Electric Tramway Co v CIR* 14.

¹⁷⁰ *Port Elizabeth Electric Tramway Co v CIR* 15.

¹⁷¹ *Port Elizabeth Electric Tramway Co v CIR* 15.

¹⁷² *Port Elizabeth Electric Tramway Co v CIR* 15.

The phrase ‘accrued to’ in terms of the definition of gross income was interpreted as meaning to which a taxpayer has become entitled. In other words an amount owing to a taxpayer must be included in its gross income. Physical receipt or lack thereof is irrelevant. The same, in terms of the judgment under consideration, is applicable to amounts owed with respect to section 11(a). Physical payment is a non-issue. In other words, in order for an expense to be deductible it is only necessary that a liability has been incurred. Consistency in approach is but one of the features of Watermeyer’s judicial stature. Such an approach, it is submitted, creates a measure of legal certainty that is so often difficult to achieve. It was briefly considered by Watermeyer whether the expense in question was capital in nature. This consideration was briefly disposed of with reference to the cases of *George Forest and Timber v CIR*,¹⁷³ *Ainsworth v Vickers*¹⁷⁴ and *Rhodesia Railways v COT*.¹⁷⁵ Watermeyer held in this regard that the expenditure in question was not of a capital nature because:

...its purpose was not that of acquiring an income producing concern and in the ordinary course it would probably be recurrent.¹⁷⁶

The distinction between capital and revenue expenditure will be made explicitly clear in the next chapter when the case of *New State Areas v CIR* is analysed. It is sufficient for the current analysis to merely accept that the expenditure in question was of a revenue nature. After firmly establishing that the expenditure was actually incurred and not of a capital nature it was left to consider, firstly, whether or not such expenditure was made ‘in the production of income’ and, secondly, whether or not such expenditure complied with the negative requirements of section 23 (g). Watermeyer held, in this regard, that if one were satisfied it would follow that so was the other. He made this clear by stating that he was of the opinion that the negative requirement of section 13 (b) was the same as the positive requirement contained in section 11 (2) (a).¹⁷⁷ He combined the two sections in order to delineate the matter in an understandable fashion by stating that:

¹⁷³ 1924 AD 527.

¹⁷⁴ 1915 2 KB 267.

¹⁷⁵ 1925 AD 438.

¹⁷⁶ *Port Elizabeth Electric Tramway Co v CIR* 16.

¹⁷⁷ *Port Elizabeth Electric Tramway Co v CIR* 16.

if expenditure is incurred “in the production of income” and “wholly and exclusively for the purposes of trade” it is deductible, otherwise not.¹⁷⁸

Watermeyer then went on to establish a two pronged test with respect to the question of whether an expense has been incurred in the production of income. This test is still recognised as a correct reflection of the law.¹⁷⁹ The first question that needs to be asked according to Watermeyer is “whether the act, to which the expenditure is attached, is performed in the production of income.” He stated in this regard that:

...provided the act is *bona fide* done for the purpose of carrying on the trade which earns the income the expenditure attendant on it is deductible.¹⁸⁰

The distinction between actually and necessarily incurred expenses was, once again, emphasised in order to clarify that expenses ‘actually’ incurred are deductible. The way in which a taxpayer runs its business is not the concern of the *fiscus*. The second question is whether the expenditure is linked sufficiently closely to the act which is performed in the production of income. In other words how closely must the expenditure in question be linked to the business operation? This question, posed by Watermeyer himself, was responded to in the following fashion:

Here, in my opinion, all expenses attached to the performance of a business operation *bona fide* performed for the purpose of earning income are deductible whether such expenses are necessary for its performance or attached to it by chance or *bona fide* incurred for the more efficient performance of such operation provided they are so closely connected with it that they may be regarded as part of the cost of performing it.¹⁸¹

This passage – although slightly modified by the case of *CIR v Genn* – has been quoted *ad nauseam* by subsequent courts and tax publications. It appears in some of the most commonly used tax textbooks and has appeared in a significant number of noteworthy

¹⁷⁸ *Port Elizabeth Electric Tramway Co v CIR* 16.

¹⁷⁹ De Koker and Williams *Silke on South African Income Tax* para 7.8.

¹⁸⁰ *Port Elizabeth Electric Tramway Co v CIR* 16.

¹⁸¹ *Port Elizabeth Electric Tramway Co v CIR* 17.

judgments. This will be returned to once an analysis of the actual judgment is complete. It is tentatively suggested that this passage also provides us with evidence of a purpose-oriented approach. A literal reading of section 11(a) may have yielded fewer possible deductions. It is very possible, using the intention of the legislature as a legal fiction, that Watermeyer came to the above conclusion in light of the commercial purpose behind the provision. This is, however, only a possibility as no evidence of his actual approach to statutory interpretation was revealed – unlike in the *Lategan* decision.

Watermeyer, on the basis of his exemplary analysis of the applicable law, thereafter, applied such to the facts of the matter. It was, essentially, held that the employment of drivers with respect to the taxpayer was a necessary activity. The employment of drivers carried the necessary risk of injury to such drivers. The risk of injury was directly linked to possible damages payments. It was held that such damages payments were “in a sense ... part of his contract of employment.” It was likened to a sick benefit or pension payment.¹⁸² The damages paid to the widow of the deceased driver in terms of the Workmen’s Compensation Act were, therefore, deductible. Watermeyer, through the use of another example, was able to deflect the argument that since the expenditure was fortuitous and dependant on chance injury, it was not sufficiently closely connected to the employment of tram drivers. He used the analogy of transport or shipping companies and the fact that ‘bad weather’ must cause additional expenses. The following was held in this regard:

Chance, in other words, increases the expenses, or makes additional expenses, but though chance causes them to arise they nevertheless remain expenses so closely linked to a necessary business operation that they can be regarded as part of the cost of performing such operation.¹⁸³

It was finally concluded with respect to the damages payments that the potential liability was inseparable from the employment of drivers and was, thus, as stated above, deductible expenditure.¹⁸⁴ It was suggested in the introduction that Watermeyer’s

¹⁸² *Port Elizabeth Electric Tramway Co v CIR* 18.

¹⁸³ *Port Elizabeth Electric Tramway Co v CIR* 18.

¹⁸⁴ *Port Elizabeth Electric Tramway Co v CIR* 19.

appetite for lengthy and considered research and analysis was an important factor aiding the valuable contribution he was to make to South African tax law. This suggestion appears to be borne out by his insistence not to rest on his conclusion reached and stated above, but to analyse comparative law in the form of two English cases. It appears that once it was determined that both were supportive of his conclusion by analogy, only then was Watermeyer able to rest. The only outstanding issue was whether the legal expenses associated with resisting the claim for compensation were also deductible. It appears from the judgment that counsel for the taxpayer did no more than argue that these expenses were equivalent to the compensatory payments and were, therefore, deductible. This was held to be an insufficient argument and such expenses were, therefore, impermissible deductions. The legal expenses were not sufficiently closely linked to the business operation.¹⁸⁵ It appears that they, therefore, failed part two of the two-pronged test established by Watermeyer. It was noted, however, that legal expenses may, in certain circumstances, be deductible. This *obiter* statement will be returned to in the next chapter when the case of *Joffe v CIR* is analysed. The overall outcome was that the compensatory payments themselves were deductible, while the legal expenses associated therewith were not.

3.4.1 Adoption, development and application of Watermeyer's *PE Electric dicta*

PE Electric was heard in the Cape Provincial Division and did not, therefore, create nationally binding precedent. The case of *CIR v Genn*,¹⁸⁶ heard some twenty years later in the Appellate Division, adopted Watermeyer's *dicta* with respect to permissible deductions. A slight modification was made to Watermeyer's original statement of the law. It is necessary to, once again, quote the relevant passage in order to understand the modification applied. The statement with respect to permissible deductions in the *PE Electric* decision was that:

...all expenses attached to the performance of a business operation *bona fide* performed for the purpose of earning income are deductible whether such expenses are necessary for its performance or attached to it by

¹⁸⁵ *Port Elizabeth Electric Tramway Co v CIR* 19.

¹⁸⁶ 20 SATC 113.

chance or *bona fide* incurred for the more efficient performance of such operation provided they are so closely connected with it that *they may be regarded* as part of the cost of performing it (own emphasis).¹⁸⁷

The modification is best understood by the following statement delivered by Schreiner JA in the *Genn* case:

If I am right in understanding the words ‘they may be regarded’ as connoting that it would be proper, natural or reasonable to regard the expenses as part of the cost of performing the operation this passage seems to state the approach to such questions correctly.¹⁸⁸

This modification is, indeed, slight. It is questionable whether the modification is materially different at all from the original statement. This debate is, however, irrelevant. What is relevant is that Watermeyer’s statement with respect to permissible deductions was adopted and applied by the Appellate Division – thus, re-characterising it as binding legal precedent. This precedent was quoted in 1962 in the case of *CIR v African Oxygen*¹⁸⁹ as the highest authority on the matter and then, again, the following year in the case of *CIR v Allied Building Society*.¹⁹⁰ It is particularly interesting to note that in the *Allied Building Society* case the court referred also to the purpose of the act to which the expenditure is attached. In other words when deciding whether an expense is capable of deduction or not the purpose behind the expenditure needs to be investigated in order to establish the nature of it. Watermeyer’s dictum to the extent that the “purpose of the act entailing expenditure must be looked to” was directly quoted and approved in this regard.¹⁹¹ The case of *Caltex Oil (SA) v SIR*,¹⁹² heard in 1975, referred to the fact that in order for an expense to be deductible it need not have been actually paid. An amount, in order for it to be deductible, need only be owed. In other words as long as the liability has been incurred a deduction is permissible. Both JA referred directly to *PE Electric* as

¹⁸⁷ *Port Elizabeth Electric Tramway Co v CIR* 18.

¹⁸⁸ *CIR v Genn* 120.

¹⁸⁹ 25 SATC 67.

¹⁹⁰ 25 SATC 343.

¹⁹¹ *CIR v Allied Building Society* 357, *Port Elizabeth Electric Tramway Co v CIR* 16.

¹⁹² 37 SATC 1.

authority. This part of Watermeyer's judgment was, therefore, only formally adopted in the *Caltex* case.¹⁹³

It is apparent, thus far, that three separate elements of Watermeyer's short *PE Electric* judgment have been adopted by the Appellate Division as correct statements of the law. The recent case of *Warner Lambert v C:SARS*,¹⁹⁴ involving the deductibility or otherwise of social responsibility expenditure, referred to yet another passage of the *PE Electric* judgment with respect to how close a connection is required between the expenditure and the income-earning operations in order to qualify as a deduction. The following statement in this regard was quoted:

Now as pointed out above, income is produced by the performance of a series of acts, and attendant upon them are expenses. Such expenses are deductible expenses provided that they are so closely linked to such acts as to be regarded as part of the cost of performing them ... The purpose of the act entailing expenditure must be looked to. If it is performed for the purpose of earning income, then the expenditure attendant upon it is deductible.¹⁹⁵

The second aspect of this passage with respect to the purpose of the expenditure was applied in the *Allied Building Society* case. The first part, however, regarding how close a connection is required in order for an expense to be deductible represents another element of Watermeyer's landmark judgment accepted as correct by the Supreme Court of Appeal (formerly the Appellate Division). The case of *Ticketin Timbers v CIR*,¹⁹⁶ heard some four years previous to *Warner Lambert*, referred to Watermeyer's marriage of section 11 (a) and section 23 (g). It was stated in the introduction to this chapter that these provisions, read together, represent the so-called general deduction formula. Section 11 (a) and section 23 (g) have been described by Watermeyer as the positive and negative aspects of the general deduction formula. Watermeyer, in his usual logical and understandable fashion, stated that the effect of the two provisions, when read together, was that:

¹⁹³ *Caltex Oil (SA) v SIR* 12.

¹⁹⁴ 65 SATC 346.

¹⁹⁵ *Port Elizabeth Electric Tramway Co v CIR* 16, *Warner Lambert v C:SARS* para 9.

¹⁹⁶ 61 SATC 399.

...if expenditure is incurred “in the production of income” and “wholly and exclusively for the purposes of trade” it is deductible, otherwise not.¹⁹⁷

It should be noted that the wording of section 23 (g) changed significantly after 1992. The only reason the pre-1992 wording was applicable in the *Tickin Timbers* case was because the cause of action occurred during the 1980’s. This particular contribution by Watermeyer has, therefore, lost its relevance. It is, however, the only contribution to come out of the *PE Electric* case to have lost its relevance. The rest of the contributions discussed above have held firm and can be considered as entrenched law with respect to section 11 (a) and permissible deductions. Whilst the union of section 11 (a) and section 23 (g) may have lost its practical relevance, it is still an excellent example of Watermeyer’s judicial ingenuity with respect to the interpretation and application of statute law.

The cases discussed in the paragraph above are all Supreme Court of Appeal decisions. It should be noted that there are a plethora of Special Court cases which refer to the *PE Electric* decision. *ITC 1710*,¹⁹⁸ *ITC 1600*,¹⁹⁹ *ITC 1545*,²⁰⁰ *ITC 1495*²⁰¹ and *ITC 1444*²⁰² represent some of the more recent Special Court decisions which make reference to the “well known principles”²⁰³ set down in the *PE Electric* case. There are a significant number of older Special Court cases which also refer to the decision. The principles are no longer questioned and have been conclusively adopted by the Supreme Court of Appeal. The only problem that occurs is the application of such principles to the particular facts of the matter in question. Litigation is, therefore, conducted on the basis of whether or not the particular matter falls within the interpretations espoused by Watermeyer. In other words the interpretations of the relevant provisions are not, themselves, disputed.

¹⁹⁷ *Port Elizabeth Electric Tramway Co v CIR* 16.

¹⁹⁸ 63 SATC 403.

¹⁹⁹ 58 SATC 131.

²⁰⁰ 54 SATC 464.

²⁰¹ 53 SATC 216.

²⁰² 51 SATC 35.

²⁰³ *ITC 1600* 137.

3.4.2 Conclusion and summary of Watermeyer's *PE Electric* contributions

The *PE Electric* judgment was presented in an, almost, lecture-like fashion. Evidence of such a suggestion lies in the exceptionally logical and understandable nature of it. His use of illustrative examples is further evidence of the lecture-like structure employed. As was stated above, the illustrative examples used provide the reader with an image of understanding that is not apparent without the examples. This use of illustrative examples together with the logical and structured fashion of the judgment contributed, it is submitted, to the wide use of his statements as authority for future decisions. Subsequent judgments were unable to put the matter in a more understandable fashion and, as such, quoted the judgment directly. Various passages from the *PE Electric* case have been adopted – as discussed above – by the Appellate Division as correct statements of the law. These passages remain the authority in their relevant spheres of operation. This is evidenced by the fact that all the primary taxation textbooks refer authoritatively to this judgment. Courts, of different hierarchies, also refer to the “well known” principles of the *PE Electric* decision. The union of section 11 (a) and section 23 (g) – although irrelevant now – was masterfully simplistic. It created a simpler test for deductible expenditure whilst keeping within the statutory directives contained in section 11 (a) when read with section 23 (g).

Watermeyer's approach to interpretation was difficult to discern in this judgment. It can, however, be quite confidently stated that a purely literal approach was, most certainly, not adopted. It was suggested above that the approach may have been purposive-oriented due to Watermeyer's recognition of the commercial purpose behind the provision in question. No firm conclusion can, however, be offered in this regard due to the lack of available evidence. This is unlike the *Lategan* decision where certain contextual factors were identified as evidence of a purposive-oriented approach. It is submitted that, while the method of approach is difficult to recognise, the result of the judgment together with the various interpretations offered are purposive in nature. With respect to the interpretation of the words “actually incurred” it appears at first glance as though a literal approach to interpretation has been employed. This reaction is not necessarily incorrect.

A literal approach can, in certain instances, accord with a purposive approach. In other words the result may very often be the same. This is made abundantly clear by Goldswain where he states that:

... in practice, the strict rule of interpretation will be used in circumstances where such interpretation is not in conflict with the overall as well as the specific intention or purpose of the legislature.²⁰⁴

The ‘strict rule of interpretation’ is equivalent to the literal approach to statutory interpretation. The deduction of expenditure with respect to section 11 (a) is probably the most contested provision in the Act. It is submitted, with this mind, that the contributions delivered in terms of this judgment are monumental and give early credence to Watermeyer’s description as a “giant of the South African judiciary.” The subsequent case discussions will add further weight to this description.

3.5 Common law principles of tax avoidance and the split decision in *Commissioner of Customs and Excise v Randles Brothers and Hudson*

The respondent in the case of *Commissioner of Customs and Excise v Randles Brothers and Hudson* carried on business as a registered importer. According to the Customs and Excise Act²⁰⁵ the respondent, as a registered importer, was able to claim a rebate of the duty imposed on materials imported for manufacture into shirts and pyjama suits. This rebate was only claimable if such materials were made specifically into these items and the manufacturer thereof was a registered manufacturer. Respondent, according to these regulations, imported the materials and transferred them immediately to a registered manufacturer. Ownership in the materials was not, however, transferred. The manufacturer would then make up the various garments and return them to the respondent. The regulations, furthermore, required that a certificate be submitted to the Collector of Customs. This was to certify that the imported materials had been transferred to a registered manufacturer. A declaration was also required from the manufacturer that the transferred materials would be made into the specific items for

²⁰⁴ Goldswain 2008 *Meditari Accountancy Research* 119.

²⁰⁵ Act 25 of 1936.

which the rebate was provided. In other words shirts and pyjama suits had to be made from the imported materials in order for the rebate to become claimable.²⁰⁶ These regulations changed, however, from the beginning of 1937. The new regulations stipulated that the registered manufacturer had to declare that the materials he received from the importer were its own property. In order for the rebate to become claimable it became necessary, therefore, for the respondent to transfer ownership in the material to the manufacturer. The respondent, in light of this development, sold the materials to the registered manufacturer. Once the garments were made up, the respondent bought them back.²⁰⁷ The procedure with respect to the new regulations was, essentially, the same as the one under the old regulations. The only difference was that the materials were transferred into the ownership of the manufacturer. Such ownership in the materials had to be declared by the manufacturer.

The Commissioner of Customs and Excise instituted action against the respondent with respect to the procedure followed by it since the implementation of the new regulations. The Commissioner contended that the materials were, at all material times, the property of the respondent. In other words it was argued by the Commissioner that there was no transfer of ownership. It was contended, on this basis, that the rebates were illegally obtained. It was also contended that the transactions were *in fraudem legis*.²⁰⁸ A direct translation of this phrase is “in fraud of the law.”²⁰⁹ Innes CJ in the case of *Dadoo v Krugersdorp Municipal Council*²¹⁰ explained the concept of *in fraudem legis* as a transaction that is:

... designedly disguised so as to escape the provisions of the law, but falls in truth within these provisions. Thus stated, the rule is merely a branch of the fundamental doctrine that the law regards the substance rather than the form of things, - a doctrine common, one would think, to every system of jurisprudence...²¹¹

²⁰⁶ *Commissioner of Customs and Excise v Randles Brothers and Hudson* 48-49.

²⁰⁷ *Commissioner of Customs and Excise v Randles Brothers and Hudson* 49.

²⁰⁸ *Commissioner of Customs and Excise v Randles Brothers and Hudson* 55.

²⁰⁹ CJ Claassen *Dictionary of Legal Words and Phrases* Vol 2 (1976) 214.

²¹⁰ 1920 AD 530.

²¹¹ *Dadoo v Krugersdorp Municipal Council* 547.

Both the Commissioner's contentions were rejected in the provincial division. Watermeyer delivered the main majority judgment in this case which Feetham and Centlivres JJA concurred in. It is interesting to note that both De Wet CJ and Tindall JA dissented. After outlining the essential facts of the case Watermeyer discussed the evidence advanced by the respondent. The evidence was to the effect that when the new regulations were published, the respondent immediately set up meetings and interviews with the appellant's department in order to understand how compliance with the regulations could be achieved.²¹² The procedure adopted, in light of this contact, by the respondent, in order to remain compliant with the regulations, was briefly set out above. The only essential difference between the new and old procedure was the passing of ownership to the manufacturer. The case of *Dadoo* was authoritatively referred to with respect to the applicable legal principles. Watermeyer stated, in this regard, that when:

... a statute forbids or taxes a certain transaction, defined by name or description, and the question arises whether a particular transaction falls within or without the prohibition or tax, two problems of interpretation or construction always arise. Firstly, the law has to be construed to ascertain what kind of transaction is forbidden or taxed, and secondly the transaction has to be interpreted to ascertain whether it is a transaction of the kind which is forbidden or taxed.²¹³

After stating that the recognised principles of statutory interpretation are to be applied, Watermeyer went on to add that the interpretation of the actual transaction was the more difficult of the two problems. The issue of "disguised transactions" was dealt with in terms of *Zandberg v Van Zyl*²¹⁴ which was, and still is, regarded as the *locus classicus* with respect to simulated or disguised transactions. A disguised transaction occurs when there is a "real intention, definitely ascertainable, which differs from the simulated intention."²¹⁵ In other words the form of the transaction is different to the substance. It was validly pointed out by Watermeyer that simply because a transaction has the effect of avoiding tax does not, necessarily, make it a disguised transaction. If the parties are honest and enter into a transaction with the intention of carrying it out according to its

²¹² *Commissioner of Customs and Excise v Randles Brothers and Hudson* 64.

²¹³ *Commissioner of Customs and Excise v Randles Brothers and Hudson* 66.

²¹⁴ 1910 AD 302.

²¹⁵ *Zandberg v Van Zyl* 309, *Commissioner of Customs and Excise v Randles Brothers and Hudson* 66.

provisions, a court cannot interfere. The distinction between such a transaction and a dishonest transaction was recognised by Watermeyer as being difficult to discern.²¹⁶ Such confusion was, however, short-lived. Watermeyer, in his usual eloquent and highly logical fashion, was able to explain the subtle difference between the two. The writer can do no better than quote him with respect to this distinction. A disguised or dishonest transaction occurs when:

... the parties to it do not really intend it to have, *inter partes*, the legal effect which its terms convey to the outside world. The purpose of the disguise is to deceive by concealing what is the real agreement or transaction between the parties. The parties wish to hide the fact that their real agreement or transaction falls within the prohibition or is subject to the tax, and so they dress it up in a guise which conveys the impression that it is outside of the prohibition or not subject to the tax. Such a transaction is said to be *in fraudem legis*, and is interpreted by the courts in accordance with what is found to be the real agreement or transaction between the parties. Of course, before the court can find that a transaction is *in fraudem legis* in the above sense, it must be satisfied that there is some expressed agreement or tacit understanding between the parties. If this were not so, it could not find that the ostensible agreement is a pretence.²¹⁷

This statement is a reflection of the common law principles of tax avoidance. In other words there are situations when no references to statutorily imposed anti-avoidance rules are necessary. A court can merely give effect to what it deems to be the real agreement. An example of such a case will be discussed below. The application of specific anti-avoidance rules contained in the Act will be discussed in the next chapter when the case of *CIR v King*²¹⁸ is analysed. It is clear from Watermeyer's judgment that he had difficulty in understanding the appellant's argument that the transaction in question was a disguised or dishonest one. The crux of the matter was the passing of ownership. The appellant contended that ownership did not pass and the purported passing of ownership was merely a sham. The parties to the transaction had, however, every reason to intend that ownership in the material was transferred. In other words the regulations stipulated that in order for the rebate to become claimable, ownership in the materials must pass. It was stated, quite poignantly, by Watermeyer that:

²¹⁶ *Commissioner of Customs and Excise v Randles Brothers and Hudson* 67.

²¹⁷ *Commissioner of Customs and Excise v Randles Brothers and Hudson* 67.

²¹⁸ 14 SATC 184.

Parties do not enter into a sham contract unless they are dishonest and unless the pretence brings them some advantage which they cannot get by entering into a real contract. In the present case there was no material advantage to be gained by pretending to enter into a contract of sale which could not be gained by entering into a real contract of sale.²¹⁹

This statement, it is submitted, struck at the heart of the matter. The simple, logical nature of this statement makes it extremely difficult to argue against. With reference to Voet Watermeyer explained that the requirements of a valid transfer of ownership with respect to movable property are satisfied after delivery – together with the requisite intention – has taken place. By intention it is meant that the transferee intends to receive the property as its own and the transferor intends to transfer ownership to the transferee. These requirements were, according to Watermeyer, most certainly, met.²²⁰ It was also noted that possession gives rise to a presumption of ownership which makes the respondent’s argument even more difficult to overcome.²²¹ It was stated with respect to intention that where “an act is voluntarily done with the expectation that a consequence will follow, that consequence is intended.”²²² Watermeyer stated this in response to De Villiers AJA’s comment in the case of *Conradie v Rossouw*²²³ to the effect that it is “not enough for the parties to think that they have the intention; the intention must be proved as a fact, apart from what they thought.” In disagreeing with this comment and responding as he did Watermeyer referred to jurisprudential philosophy for authority with respect to the meaning of intention.²²⁴ The fact that jurisprudential philosophy was referred to in order to determine the correct, or most appropriate, meaning of intention is further evidence of Watermeyer’s holistic, pragmatic and logical approach to legal interpretation. Watermeyer’s enquiring nature did not allow him to merely accept a comment by a previous Appellate Division judge as correct. His appetite for flawless research and objectivity had to be satisfied by covering all possible bases which resulted in him disagreeing with De Villiers AJA (as he was then) – one of South Africa’s most

²¹⁹ *Commissioner of Customs and Excise v Randles Brothers and Hudson* 71.

²²⁰ *Commissioner of Customs and Excise v Randles Brothers and Hudson* 69.

²²¹ *Commissioner of Customs and Excise v Randles Brothers and Hudson* 72.

²²² *Commissioner of Customs and Excise v Randles Brothers and Hudson* 69.

²²³ 1919 AD 279.

²²⁴ *Commissioner of Customs and Excise v Randles Brothers and Hudson* 69.

preeminent judges of all time. Watermeyer's conclusion, it is submitted, is summed up by the following statement with respect to the respondent:

It was so much in their interest to have the intention of transferring ownership that it is difficult to believe that they did not have it.²²⁵

It is difficult to even comprehend another conclusion to the matter. De Wet CJ and Tindall JA found, on the contrary, however, that no genuine sale existed. A brief discussion of De Wet CJ's judgment is necessary in order to appreciate the fundamental difference in approach between the majority and minority decisions. De Wet CJ, with respect to simulated or disguised transactions, stated that:

... the court must give effect to the transaction according to what it finds to be the real intention of the parties.²²⁶

In other words intention – as it was for Watermeyer – was all important. With reference to *Zandberg* De Wet CJ stated that it was necessary, when dealing with disguised transactions, to examine the circumstances surrounding the transaction as well as the circumstances leading up to the transaction.²²⁷ De Villiers AJA's comment with respect to intention was, as discussed above, rejected by Watermeyer. De Wet CJ, on the other hand, agreed with it. This, it is submitted, is a fundamental divergence as to the meaning of intention. De Wet CJ was of the opinion that in order for a party to have a genuine intention; it must be borne out by the party's actual intention as well as the surrounding facts.²²⁸ Watermeyer, on the other hand, was satisfied once it was shown that the parties had genuine intention. It, in fact, appeared as obvious to him that the parties had the requisite intention due to the fact that having such intention was extremely beneficial in the circumstances. De Wet CJ, furthermore, emphasised, that such intention was a question of fact to be determined on a case by case basis. De Wet CJ, in light of this, found the various features of the sale agreement unusual. One of the main points

²²⁵ *Commissioner of Customs and Excise v Randles Brothers and Hudson* 72.

²²⁶ *Commissioner of Customs and Excise v Randles Brothers and Hudson* 57.

²²⁷ *Commissioner of Customs and Excise v Randles Brothers and Hudson* 57.

²²⁸ *Commissioner of Customs and Excise v Randles Brothers and Hudson* 58.

advanced by him was that, while the respondent purported to pass ownership and the manufacturer purported to receive it, none of the usual benefits of ownership accrued to the manufacturer.²²⁹ In other words the manufacturer was unable to alienate the material in any way it pleased and the respondent still held a measure of control over the materials. Ownership cannot, as was noted by Watermeyer, be equivalent to control.²³⁰ Watermeyer noted, also, that the regulations required the manufacturer to receive as his own property the materials in question. The regulations did not state that the materials must become the property of the manufacturers:

... untrammelled by any contractual obligations to manufacture the articles into specified garments and sell them to the importer after they have been manufactured.²³¹

At first glance it may appear as though Watermeyer adopted a strictly literal approach to the reading of the regulation. While the approach adopted is, indeed, literal it must be remembered that a literal approach is often in accordance with other approaches.²³² In other words a particular provision may have the same meaning regardless of approach. It would do the reader well to bear in mind Kentridge AJ's statement in the *Zuma* case to the effect that even when a purposive or teleological approach to interpretation is employed, the language of the provision remains of significant importance. The language of the regulation in terms of the Customs and Excise Act was not capable of being extended in the fashion quoted immediately above.

De Wet CJ held, on the basis of the unusual characteristics and the, somewhat, artificial procedure adopted by the respondent with respect to the new regulations that the transactions were not sale agreements. There was no genuine intention to transfer or receive on the part of either the respondent or the manufacturer.²³³ In accordance with his statement quoted above De Wet CJ found that the parties expressed intention was not their real intention. This is, somewhat, confounding when reference to Watermeyer's

²²⁹ *Commissioner of Customs and Excise v Randles Brothers and Hudson* 59.

²³⁰ *Commissioner of Customs and Excise v Randles Brothers and Hudson* 70.

²³¹ *Commissioner of Customs and Excise v Randles Brothers and Hudson* 71.

²³² Goldswain 2008 *Meditari Accountancy Research* 119.

²³³ *Commissioner of Customs and Excise v Randles Brothers and Hudson* 62.

judgment is made. Since the regulations mandated that ownership is required it would be surprising if the respondent and the manufacture did not have a real intention to transfer ownership. It was also suggested by De Wet CJ that in order to determine whether a genuine intention exists the surrounding circumstances must be taken into account. It is submitted that the surrounding circumstances only served to strengthen the respondent's case. The fact that respondent's procedure changed as a result of the new regulations was, it is submitted, the most important surrounding circumstance leading up to the transaction. The new regulations stipulated that ownership must vest – in order for a rebate to become claimable – in the manufacturer. It is submitted, in line with Watermeyer's contention that this circumstance only lends further credence to respondent's argument, that a genuine intention existed. In other words if the regulations had not changed the respondent would have had no reason to intend to pass ownership. De Wet CJ also stated that the question of intention was a question of fact to be determined with reference to the peculiar facts of each case.²³⁴ It is submitted that the specific facts of this case appear to sustain respondent's argument rather than marginalise it. The next section will discuss Watermeyer's *dicta* in this case with reference to modern case law.

3.5.1 The Ladysmith saga and the approval of Watermeyer's dicta

The case of *Erf 3183 / 1 Ladysmith (Pty) Ltd v CIR*²³⁵ involved a scheme whereby a subsidiary company held a piece of vacant land. Its holding company desired to build a factory on this land. If the subsidiary company had merely let the property in question to its holding company with a stipulation to the effect that the holding company construct a factory on such land, no issue would have arisen. The right to have such improvements effected would have been included in the lessor's gross income in terms of paragraph (h) of the definition of gross income. Section 11 (f) would have allowed a corresponding deduction for the lessee. Instead of this ordinary approach, it was decided, on the basis of

²³⁴ *Commissioner of Customs and Excise v Randles Brothers and Hudson* 58.

²³⁵ 58 SATC 229.

advice, to interpose a third party.²³⁶ The subsidiary company leased the vacant land to a particular pension fund. The lease stated that the fund *may* effect improvements. It must be noted that in order for such a right to be included in gross income in terms of paragraph (h) it must be obligatory.²³⁷ In other words the use of the word ‘may’ rendered the improvements non-taxable. For paragraph (h) to become applicable an enforceable right in terms of improvements against the lessee must exist. The fund, in terms of a separate agreement, let the vacant piece of land to the holding company. This agreement stipulated that the company was obliged, as the sub-lessee, to construct a factory upon the land.²³⁸ Ordinarily, therefore, this right would have been valued and included in the Fund’s gross income in terms of paragraph (h). The Pension Fund was, however, a tax exempt entity.²³⁹ The right to have improvements effected on the plot of land in terms of its position as sub-lessor was, therefore, not taxable. The effect of the scheme was that paragraph (h) was avoided by all the parties involved and the sub-lessee was entitled to a section 11 (f) deduction.

The Commissioner’s response to the scheme was to include the right to have the improvements effected in the subsidiary’s gross income. The Commissioner, essentially, disregarded the individual lease agreements and gave effect to what he believed the real agreement was. Appellant, in objecting to such a reaction, relied substantially on Lord Tomlin’s *dicta* in the case of *IRC v Duke of Westminster*²⁴⁰ which stated that:

Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however, unappreciative the Commissioners of Inland Revenue or his fellow-taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.²⁴¹

Respondent, on the other hand, referred the court to both the *Zandberg* and *Randles Brothers* decisions. It was noted by Hefer JA, as it was above, that *Zandberg* is regarded

²³⁶ *Erf 3183 / 1 Ladysmith (Pty) Ltd v CIR* 236.

²³⁷ L Olivier “*Erf 3183/1 Ladysmith (Pty) Ltd and Another v CIR*” 1997 *De Rebus* 242 at 242.

²³⁸ *Erf 3183 / 1 Ladysmith (Pty) Ltd v CIR* 235.

²³⁹ *Erf 3183 / 1 Ladysmith (Pty) Ltd v CIR* 242.

²⁴⁰ [1936] AC 1.

²⁴¹ *IRC v Duke of Westminster* 19.

as the *locus classicus* on simulated or disguised transactions.²⁴² Whilst this was quoted as the *locus classicus* on the matter, it is interesting to note that Watermeyer's above explanation of the *Zandberg* principle was quoted at length by Hefer JA who went on to add that:

I have quoted the relevant passages from the *leading cases* in full in order to reveal the fundamental flaw in a submission which tinged the entire argument for the appellants (own emphasis).²⁴³

Hefer JA, essentially, adopted Watermeyer's *Randles Brothers dicta* as a development of or addition to the *Zandberg* principle.²⁴⁴ It seems that both *Zandberg* and *Randles Brothers*, together with the case under discussion, will now be regarded as the leading authority, read together, on the matter of simulated transactions. Evidence of this is the case of *Relier v CIR*²⁴⁵ which was heard by the Supreme Court of Appeal²⁴⁶ approximately a year later and contained very similar facts to the Ladysmith saga. The *Ladysmith* case was unequivocally adopted and applied. This, in turn, means that the *Zandberg* decision as explained or developed by Watermeyer in *Randles Brothers* and applied by Hefer JA is settled law. It is quite interesting that none of the other judges who delivered separate judgments in the *Randles Brothers* decision were, even, acknowledged by Hefer JA. It should be noted for the sake of completeness that the appellants in the Ladysmith saga were unsuccessful. Hefer JA managed to reconcile Lord Tomlin's principle with the substance versus form principle by stating that a court must give effect to the tenor of an agreement where the parties have the honest intention to abide by it. Lord Tomlin's principle is, thus, given effect to where the parties honestly intend for the particular contract to have effect according to its provisions. Where, however, a court is not satisfied that the terms of the agreement are the actual agreement; it may have regard to the substance of the transaction rather than its form. This is precisely where the facts of the *Ladysmith* case and those of the *Randles Brothers* case diverge. The parties to the Ladysmith scheme never intended to give effect to the signed

²⁴² Erf 3183 / 1 *Ladysmith (Pty) Ltd v CIR* 239.

²⁴³ Erf 3183 / 1 *Ladysmith (Pty) Ltd v CIR* 240.

²⁴⁴ P Solomon "Substance v Form – Paragraph (h) of 'Gross Income'" 1996 *Annual Survey* 857 at 860.

²⁴⁵ 60 SATC 1.

²⁴⁶ The Appellate Division was renamed the Supreme Court of Appeal after the *Ladysmith* decision and before the *Relier* decision.

leases. In other words the court was satisfied that there was a “real intention, definitely ascertainable, which differs from the simulated intention.” The court was satisfied, on the evidence, that the interposition of the tax exempt entity was merely a disguised transaction aimed at evading paragraph (h) of the definition of gross income. The respondent in the *Randles Brothers* decision quite clearly intended to comply with the new regulations in order to claim the rebate. The evidence pointed to the fact that respondent went to great lengths to achieve compliance and the sale of the materials was an honest one. There is an extremely fine line which may appear, initially, at least, confusing. It could be argued that the parties in the *Ladysmith* case honestly intended to give effect to the various leases because it was so much in their interest to do so. There was, however, too much condemning evidence against them. It was held that the main lessor, despite the fact that no obligation was created contractually, could have enforced the right contained in the sub-lease to the extent that a factory must be built on the vacant land. In other words the evidence showed that the tax exempt entity interposed had no real influence. Evidence in the *Randles Brothers* decision, on the other hand, was to the effect that the parties involved in the sale transaction intended the transaction to have effect according to its tenor. Olivier states that:

Some tax lawyers are of the opinion that the effect of the judgment (*Ladysmith*) is that all tax-motivated agreements will be ignored if the substance of the agreement does not correspond with the form thereof.²⁴⁷

She is of the opinion, however, that this is “reading too much into the judgment.”²⁴⁸ Whilst Olivier does not acknowledge the significance of the *Randles Brothers* decision, it is suggested that this case would have lent significant support for her opinion. In other words the respondent in the *Randles Brothers* decision intended and, indeed, did give effect to provisions of the sale agreement it entered into. The fact that one of its main aims was to secure the allowable rebate was irrelevant. The agreement was given effect – honestly and meaningfully – according to its tenor.

²⁴⁷ Olivier 1997 *De Rebus* 243.

²⁴⁸ Olivier 1997 *De Rebus* 243.

Please note that section 11(f) was subsequently amended to provide that if the amount is not taxable in the hands of the lessor, the lessee does not qualify for the deduction.

3.5.2 Conclusion and summary of Watermeyer's *Randles Brothers* contributions

Once again we have seen Watermeyer's *dicta* applied to a novel situation devised by cunning tax consultants. The *Randles Brothers* decision dealt with an entirely different scheme in terms of a different taxing act. It is, nevertheless, common law authority for what is required in order for a court to strike down a simulated or disguised transaction. Whilst this judgment has certainly not displaced *Zandberg* as the *locus classicus* it has, together with the *Ladysmith* decision, developed and explained it. The logical structuring of the argument as well as the weighing up of evidence provides readers with a very thorough understanding of the issues, the principles and the conclusion. It was stated above that Watermeyer was the only judge referred to by Hefer JA in the *Ladysmith* decision. This was clearly as a result of his lucid and understandable judgment delivered in the face of the then Chief Justice dissenting on fundamental issues. Evidence of his impeccable research was once again displayed by his reference to jurisprudential philosophy as to the meaning of intention. He disagreed with a previous Appellate Division judge as well as the then current Chief Justice as to the meaning of intention. Further evidence of his research skill is apparent when reference to his explanation of what is required in order to pass ownership is made. Reference to Voet, a well known Roman-Dutch authority, is made with respect to the requirements of a valid sale. Overall this judgment is extremely considered and an excellent illustration of highly logical judicial reasoning. Whilst this is not ordinarily considered to be one of his 'landmark' judgments, it must, nevertheless, be regarded as a major contribution with respect to tax avoidance - which has become an extremely heated topic in recent years with various schemes being implemented to circumvent the taxation authorities. The extent of his contribution to the issue of tax avoidance will become more apparent when reference to *CIR v King*, in the next chapter, is made.

3.6 Conclusion

The three cases that have been analysed can be considered as major contributions to South African tax law. These judgments have been analysed and Watermeyer's renowned statements of the law quoted. Reference to modern case law and publications where such statements have been quoted has also been made. This was done in order to highlight the influential nature of his interpretations of the law in question. His approach to statutory interpretation was shown, in parts, to be a purposive-oriented method. Whilst this was not always discernible, reference to the fact that the prevailing approach to fiscal interpretation was a starkly literal one was suggested as being a possible reason for the lack of evidence with respect to interpretation. The fact that his judgments are practically relevant and, in many cases still leading authority, is beyond doubt. It is further submitted that one of the reasons for such influence is the way in which his judgments were delivered. His judicial reasoning, structure and use of examples to illustrate the practicality of a particular interpretation should be considered as a contribution on its own. In other words it would do modern-day judges, dealing particularly with tax matters, well to take note of his style of judgment. The fact that they are so understandable is, without doubt, another reason for their remarkable durability. Their durability of application was also linked to their diversity of application. In other words their timeless nature means they can be applied to novel situations in an ever-changing society. This point will also be alluded to in the next chapter.

Watermeyer's next appointment was to be his final one. Four of his most noteworthy and influential judgments as Chief Justice will be analysed in the subsequent chapter. While he had already progressed some distance to deserving his giant status as a judge, more was to follow that would cement his description or status as a "giant of the South African judiciary."

CHAPTER FOUR: WATERMEYER'S CONTRIBUTIONS AFTER HIS APPOINTMENT AS CHIEF JUSTICE

4.1 Introduction

Watermeyer's appointment to the position of Chief Justice came as no surprise and was, indeed, much anticipated. It has been said in biographical material that many of his counterparts predicted he would one day become Chief Justice.²⁴⁹ His "carefully prepared and lucid arguments as an advocate"²⁵⁰ bore testament to such a prediction. His logical, clear and lucid approach to delivering judgments was discussed in the previous chapter and will be developed and expounded on with reference to further case law in this chapter. Watermeyer took over the role, from his predecessor De Wet CJ, until he retired from active service at the age of seventy.²⁵¹ The chronological approach to his contributions will be continued in this chapter together with the same style of analysis as adopted in the previous chapter. The cases of *Joffe v CIR*,²⁵² *CIR v Lever Brothers & Unilever*,²⁵³ *New State Areas v CIR*²⁵⁴ and *CIR v King*²⁵⁵ will be analysed and discussed in this order. It is quite remarkable that the first three judgments were all delivered in the space of approximately six months. The *Joffe* and *New State Areas* decisions built on Watermeyer's interpretation of section 11(a). The *Lever Brothers* decision dealt with the interpretation of the word 'source' with respect to the general definition of gross income and is a particularly good example of his lucid and clear style of argument. The *King* decision is based on old general anti-avoidance provisions. His interpretation, in that judgment, has, however, found recognition in the latest general anti-avoidance provisions in terms of sections 80A – 80L. The relevant provisions of the Act were quoted in the previous chapter and, as such, will not be repeated here. The anti-avoidance provisions with respect to the *King* decision will be quoted when that case is analysed. The durability of his various interpretations and statements of the law will once again be

²⁴⁹ CG Hall (ed) 1943 *SALJ* 429.

²⁵⁰ HR Hahlo and RG McKerron (ed) 1950 *SALJ* 332.

²⁵¹ Southwood 1990 *Consultus* 29.

²⁵² 13 SATC 354.

²⁵³ 14 SATC 1.

²⁵⁴ 14 SATC 155.

²⁵⁵ 14 SATC 184.

highlighted. The first judgment to be analysed will be that of *Joffe*. It will do the reader well to bear in mind the facts of the *PE Electric* decision as well as the decision that was finally made in that case throughout the following analysis.

4.2 *Joffe* versus *PE Electric*: Similar facts, different outcome

The facts and issues of *Joffe* are extremely important in order to understand how and why Watermeyer came to a conclusion different to that of the *PE Electric* decision. The appellant carried on business as constructional engineers. The appellant taxpayer secured a contract for the execution of reinforced concrete work in connection with the erection of a particular building. Subsequently the concrete hood which had been installed by the appellant collapsed killing one of its workmen. The dependants of the worker were successful in a delictual action against the appellant. The appellant, as a result of this, attempted to deduct the damages payments as well as the associated legal expenses. The Commissioner was not, however, in agreement with the taxpayer as to the nature of the expenditure and neither was the High Court.²⁵⁶ It is interesting to note, however, that the Special Court did rule in appellant's favour with respect to both the damages payments and the associated legal costs.²⁵⁷ The essential issue to be determined by the court was whether the expenses in question were capable of deduction with respect to section 11(2)(a) read with section 12(g).²⁵⁸ It must be noted that section 11(2)(a) was materially the same as the current section 11(a). Section 12(g) was materially the same as section 13(b) referred to in the *PE Electric* case. The reader is referred to chapter three in this regard.

Interestingly, the appellant's contention was to the effect that the expenses in question were deductible because they were part of the real cost of appellant's operation as performed in the manner the taxpayer chose to perform it.²⁵⁹ They did not argue that the

²⁵⁶ *Joffe v CIR* 355.

²⁵⁷ *Joffe v CIR* 356.

²⁵⁸ *Joffe v CIR* 356.

²⁵⁹ *Joffe v CIR* 356.

expenses “were part of the ordinary cost of performing the operation.”²⁶⁰ It is, somewhat, confusing given the partial success of the taxpayer in the *PE Electric* case that the exact same approach was not followed. In other words the taxpayer in *PE Electric* contended that the damages payments together with the associated legal expenses were part of the ordinary costs associated with the running of a tramway company. The argument was not personalised in the way the *Joffe* argument was. By personalised it is meant that the industry as a whole was not referred to – only the actual business of the individual taxpayer. Watermeyer made it very clear in the *PE Electric* decision that expenses ‘actually incurred’ are deductible as well as expenses ‘necessarily incurred.’²⁶¹ The following example was quoted in the previous chapter:

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.²⁶²

It is suggested that this statement together with Watermeyer’s emphasis on ‘actually incurred’ as opposed to ‘necessarily incurred’ are the reasons the taxpayer, in the *Joffe* case, chose to personalise its argument. Watermeyer referred, in the *Joffe* judgment, authoritatively to the English case of *Strong & Co v Woodfield*²⁶³ where, with respect to the equivalent of our section 12(g), it was emphasised that the purpose of the expenditure is important. Watermeyer stipulated that the wording of section 12 (g) appeared, in the words of the English court, to:

... mean for the purpose of enabling a person to carry on and earn profits in the trade, etc. I think the disbursements permitted are such as are made for that purpose. *It is not enough that the disbursement is made in the course of, or arises out of, or is connected with the trade or is made out of profits of the trade.* It must be made for the purpose of earning the profits: All expenditure, therefore, necessarily attached to the performance of the operations which constitute the carrying on of the income-earning trade, would be deductible and also all expenditure, which, though not attached to the trading operations of necessity, is yet

²⁶⁰ *Joffe v CIR* 356.

²⁶¹ *Port Elizabeth Electric Tramway Co v CIR* 15.

²⁶² *Port Elizabeth Electric Tramway Co v CIR* 15.

²⁶³ 1906 AC 448.

bona fide incurred for the purpose of carrying them on, provided such payments are wholly and exclusively made for that purpose and are not expenditure of a capital nature (own emphasis).²⁶⁴

Watermeyer accepted this as a correct statement of the applicable law with respect to section 12 (g) – the negative aspect of the general deduction formula. It was stated in the *PE Electric* case, however, that the negative aspect of the general deduction formula is, essentially, the same as the positive one which asks whether the expenditure was incurred ‘in the production of income.’²⁶⁵ In other words the test for satisfying the one is equivalent to the other. After this determination Watermeyer, in the *PE Electric* decision, went on to state his famous passage with respect to what constitutes deductible expenditure. For the sake of the current argument it is necessary that it is once again stated. He stated as follows:

Here, in my opinion, all expenses attached to the performance of a business operation *bona fide* performed for the purpose of earning income are deductible whether such expenses are necessary for its performance or *attached to it by chance* or *bona fide* incurred for the more efficient performance of such operation provided they are so closely connected with it that they may be regarded as part of the cost of performing it (own emphasis).²⁶⁶

It is submitted that the passage quoted from the *Woodfield* decision postulates a narrower construction of the general deduction formula. The italicised sentence in terms of the *Woodfield* quotation appears to provide evidence of this suggestion. Watermeyer, in the *PE Electric* judgment, appears, however, to accept that similar expenditure was deductible. Evidence of this is italicised directly above. The fact that the taxpayer was negligent in the case under discussion appears to have been a significant factor in the outcome of the case. After stating in the *PE Electric* decision that:

... provided the act is *bona fide* done for the purpose of carrying on the trade which earns the income the expenditure attendant on it is deductible.²⁶⁷

²⁶⁴ *Strong & Co v Woodfield* 453, *Joffe v CIR* 357.

²⁶⁵ *Port Elizabeth Electric Tramway Co v CIR* 16.

²⁶⁶ *Port Elizabeth Electric Tramway Co v CIR* 17.

²⁶⁷ *Port Elizabeth Electric Tramway Co v CIR* 17.

He went on to qualify this statement by adding that:

If the act done is unlawful or negligent and the attendant expense is occasioned by the unlawfulness or, possibly, the negligence of the act, then probably it would not be deductible.²⁶⁸

This statement was clearly *obiter*. No reference to this passing remark by Watermeyer was made in the *Joffe* judgment. It is very possible, however, that Watermeyer, himself, wanted to give credence to a previous remark in order to maintain judicial consistency. This is suggested in light of the outcome of *Joffe* where all the claimed expenses were held to be impermissible deductions. The taxpayer referred the court to the Australian case of *The Herald & Weekly Times v Federal Commissioner of Taxation*²⁶⁹ which involved a taxpayer arguing the validity of a deduction claimed in terms of damages it had been ordered to pay. The damages were ordered in terms of defamatory material the taxpayer had published.²⁷⁰ The majority of the Australian court took the view that such a deduction was permissible due to the fact that it was an inevitable concomitant of the newspaper business trade.²⁷¹ This was, essentially, the principal authority on which the taxpayer relied. Watermeyer in reaction to this authority stated that it was of no use to the taxpayer because there was no evidence that:

...negligence such as occurred when the cantilever hood was being constructed and the liability incurred thereby are the inevitable concomitants of the business of a reinforced concrete engineer. Consequently this case does not fall within the principle applied by the majority of the Court in the Australian case.²⁷²

Williams, in apparent bemusement with this statement, postulates that the “damages were the result of human error or negligence.”²⁷³ Williams then goes on to ask whether a court requires “evidence that error and negligence are inevitable in all human activities.”²⁷⁴ He is, essentially, stating, simply, that accidents do happen and it is – inextricably – a part of human nature. In other words evidence of such happenings should not be required by a

²⁶⁸ *Port Elizabeth Electric Tramway Co v CIR* 17.

²⁶⁹ 2 Australian Tax Decisions 169.

²⁷⁰ *Joffe v CIR* 358.

²⁷¹ *Joffe v CIR* 358.

²⁷² *Joffe v CIR* 359.

²⁷³ Williams *Income Tax in South Africa Cases and Materials* 373.

²⁷⁴ Williams *Income Tax in South Africa Cases and Materials* 373.

court of law. The writer is in humble agreement with Williams up until this point. Williams then appears to lose sight of the actual argument that was delivered by the taxpayer. It will be remembered that the taxpayer argued that the damages payable as well as the associated legal expenses were actual costs incurred by the taxpayer due to the manner in which the taxpayer, itself, performed its business. Williams, in apparent confusion, postulates the following issue:

Moreover, the issue is surely whether a particular hazard is an inherent risk of the business of a concrete engineer, and not (as Watermeyer suggests) whether the particular taxpayer carried on business in a way which was likely to lead to accidents.²⁷⁵

Watermeyer did not, however, suggest that the issue was to be personalised to the actual taxpayer. He was merely responding, as a judge should, to the argument put before him by the taxpayer. The reader will remember Watermeyer's insistence on the difference between expenditure actually incurred and necessarily incurred as well as the example involving extravagancy and inefficiency. It was suggested above that it was these statements by Watermeyer that led the taxpayer to, essentially, personalise its argument in the *Joffe* case. Watermeyer came to the decision that the taxpayer had not shown that negligence such as occurred in this case was a necessary concomitant of the taxpayer's trade. This is a slightly confusing conclusion when regard is had to the argument employed by the taxpayer. The fact that such negligence did occur showed that such a risk was, therefore, inherent in the taxpayer's business in the manner it conducted it. The Act does not stipulate that a taxpayer is legally obliged to perform his trade in the most efficient manner. Indeed, this is exactly what Watermeyer, himself, held in the *PE Electric* decision. This criticism has not, however, been levelled before and the *Joffe* judgment has been interpreted by subsequent courts as not laying down any hard and fast rules with regard to the deduction of expenditure linked to negligent acts.²⁷⁶ For example the court in the very recent case of *ITC 1837*²⁷⁷ held with respect to the *Joffe* judgment that:

²⁷⁵ Williams *Income Tax in South Africa Cases and Materials* 373.

²⁷⁶ *ITC 1837* 71 SATC 177.

²⁷⁷ 71 SATC 177.

Expenditure flowing from the negligent performance of a trading operation is deductible only if such expenditure is a ‘necessary concomitant thereof – an approach followed in *Weinberg v Commissioner for Inland Revenue*; ... and according to RC Williams: *Income Tax in South Africa* ... also by the Commissioner.²⁷⁸

The *Joffe* decision has, in other words, been interpreted on the basis that the taxpayer did not submit sufficient evidence for Watermeyer to hold that the negligence that occurred was a ‘necessary concomitant’ of the taxpayer’s trade. It is also interesting to note that Watermeyer specifically stated, before ruling against *Joffe*, that there was no evidence in the stated case to suggest that “negligence such as occurred”²⁷⁹ was an inevitable concomitant of the business of reinforced concrete engineering.²⁸⁰ This was very possibly due to the fact that the taxpayer was of the firm belief that no such evidence was required given the personal nature of its argument together with Watermeyer’s insistence on the difference between actually and necessarily incurred expenditure. The fact that negligence actually occurred provided sufficient evidence to prove that such negligence was an inherent risk in the business of the taxpayer in the way the particular taxpayer performed it. The expenditure associated therewith should, therefore, have been deductible. This submission is made stronger when reference to *PE Electric* is made with regard to the inefficient businessman and the deductibility of chance expenditure. The taxpayer was, nevertheless, unsuccessful in this regard.

A final contention by the taxpayer was to the effect that if the payments were not deductible as expenses incurred they should be deductible as ‘losses’ incurred in the production of income. This contention brought about one of the more striking or long-lasting features of this judgment. In describing what constitutes a ‘loss’ Watermeyer stated that:

²⁷⁸ *ITC 1837* 184-185.

²⁷⁹ *Joffe v CIR* 359.

²⁸⁰ *Joffe v CIR* 359.

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.²⁸¹

This particular interpretation has been quoted by a number of subsequent tax publications.²⁸² It must be noted that the phrase ‘expenditure and losses’ is not defined in the Act. Equally extensively quoted has been Watermeyer’s subsequent suggestion that he was not convinced that ‘losses’ meant anything different from ‘expenditure’ in the relevant provision.²⁸³ The final contention brought by the taxpayer was, therefore, disposed of and its appeal dismissed.

Watermeyer, in terms of *PE Electric*, expressly sanctioned the deduction of chance expenditure with respect to trading operations. The expenses caused as result of negligence in the *Joffe* case were, however, disallowed. It is suggested that a negligent occurrence in pursuit of a trade is palpably chance expenditure linked to the business operation. The fact that the chance compensation payments were allowed in *PE Electric* decision and the chance payments caused by negligence in *Joffe* were not appears to be a wholly arbitrary and inconsistent result. It is suggested, also, that the slightly narrower construction placed by Watermeyer on the general deduction formula aided the *fiscus* in winning its case. It could be argued that it was not a narrower construction but merely a construction placed on another section. In other words Watermeyer’s famous *PE Electric* passage with respect to deductible expenditure was based on section 11 (a) while the *Woodfield dicta* adopted was with respect to section 12 (g). This argument falls away as soon as it is recognised that Watermeyer, in the *PE Electric* case, stated that the positive and negative parts of the general deduction formula – in other words section 11 (a) and section 12 (g) – postulated the same requirements and, therefore, the same test. The approach to interpretation that was employed by Watermeyer in this case is difficult to determine. Once again, it is not stated which approach is actually followed. No mention

²⁸¹ *Joffe v CIR* 360.

²⁸² De Koker and Williams *Silke on South African Income Tax* para 7.4, Huxham and P Haupt *Notes on South African Income Tax* 27 ed (2008) 90 and Williams *Income Tax in South Africa Cases and Materials* 342.

²⁸³ *Joffe v CIR* 360.

of the ‘intention of the legislature’ is even made. The following section will briefly document the *Joffe* decision’s contributions to South African tax jurisprudence.

4.2.1 The significance of *Joffe*: Expenditure and losses

Whilst it is readily conceded by the writer that this judgment was not the most illuminating of Watermeyer’s fine career, it is interesting to note that there has not, as yet, been a concrete attempt by our courts to define the difference, if any, between ‘expenditure’ and ‘losses.’²⁸⁴ More specifically there has been no definite finding as to the definition or meaning of the term ‘losses’ as it stands in section 11(a). The *Joffe* judgment is considered, however, to be the closest we have come to such a development and is quoted by De Koker and Williams at the beginning of the relevant section in *Silke*.²⁸⁵ This provides evidence that it is, essentially, the starting point of any discussion or analysis of the meaning of the phrase ‘expenditure and losses’ as it stands in section 11(a). It has also been quoted in various other textbooks, publications and judgments alike. An example of a recent judgment where the suggested difference between expenditure and losses was quoted was in *CIR v Creative Production*.²⁸⁶ Counsel for the appellant was attempting to persuade the Natal Provincial Division that a different meaning should be placed on the word ‘loss’ as opposed to ‘expenditure.’ This was due to the fact that the appellant’s argument had been premised on a distinction between expenditure and losses. Levinsohn J, while recognising the suggested distinction between expenditure and losses, went on to quote Watermeyer’s subsequent remark to the effect that there is no difference between expenditure and losses.²⁸⁷ This case is illustrative of the, somewhat, peculiar situation that exists with respect to the difference between expenditure and losses in section 11(a). While Watermeyer’s *obiter* remark as to the possible difference in meaning between ‘expenditure’ and ‘losses’ is, essentially, the starting point or fundamental authority on such a debate, his judgment in the *Joffe* case is also recognised as the leading authority for the fact that there is no difference in

²⁸⁴ De Koker and Williams *Silke on South African Income Tax* para 7.4.

²⁸⁵ De Koker and Williams *Silke on South African Income Tax* para 7.4.

²⁸⁶ 61 SATC 106.

²⁸⁷ *CIR v Creative Production* 109.

meaning between ‘expenditure’ and ‘losses.’ The suggested distinction remains a persuasive *obiter* remark while the statement that no difference exists in the context of section 11(a) is binding law. It is binding law due to the fact that it was delivered by the Appellate Division and has not, as yet, been overturned or amended. This is further, evidence of the remarkable durability of his judgments. The case of *New State Areas* – which will be discussed later in this chapter – will complete Watermeyer’s all round – and still applicable – interpretation with respect to section 11(a).

4.2.2 Conclusion and summary of Watermeyer’s Joffe contributions

While it has been conceded that this judgment provided the least substantial contribution to South African tax law when compared to the other judgments under analysis, it is nevertheless an interesting judgment that provides the reader with one of the very few examples of conjecture in relation to Watermeyer’s judgments. This is suggested in light of the criticism levelled at it by Williams as well as the writer of this thesis. The main contribution of the *Joffe* judgment is undoubtedly its double-edged offerings with respect to what constitutes expenditure as opposed to losses. It was stated above that no firm definition of the word ‘losses’ in section 11(a) exists. Watermeyer, however, stated, authoritatively, in this judgment that it has the same meaning as the word ‘expenditure.’ This is still accepted as a correct reflection of the law.²⁸⁸ The offering with respect to the difference between expenditure and losses is described as double-edged due to the fact that Watermeyer’s *obiter* remark with respect to the difference in meaning between the two words is usually cited as the basis for any discussion on this matter.²⁸⁹ The reason for Watermeyer’s seemingly incongruent contribution in this regard is that the possible difference in meaning between the words was referred to generally. In other words the *obiter* remark was not made in the context of section 11(2)(a). His statement to the effect that there was no difference in meaning was with specific reference to section 11(2)(a). This judgment was not the most logical or lucid of the analysed judgments. The importance of negligence as a factor was not made particularly clear by Watermeyer and

²⁸⁸ *CIR v Creative Production* 109.

²⁸⁹ De Koker and Williams *Silke on South African Income Tax* para 7.4.

neither was the reason for the narrower construction placed on the general deduction formula. It has, nonetheless, stood the test of time with respect to the difference in meaning, if any, between expenditure and losses.

4.3 Source and the *Lever Brothers* principle

It must first be noted that South Africa changed from a source-based system of taxation to a residency-based system of taxation in 2001.²⁹⁰ The issue of source with respect to the definition of gross income is now only relevant to non-residents and is, therefore, of less importance than it previously was. The case of *CIR v Lever Brothers and Unilever*²⁹¹ and the judgment delivered by Watermeyer is, without question, the leading authority on the interpretation of the word ‘source’ as it appears in the definition of gross income in section 1 of the Act. The reader is referred to this definition in chapter three above. The need for interpretation is due to the absence of a statutory definition in the Act. The respondent in this case was an English company. A particular Dutch company acquired assets from the respondent for which it became indebted to respondent for the amount of £11 000 000. It also agreed to pay interest on this amount at a particular rate.²⁹² Certain shares in an American company owned by the Dutch Company were transferred to a different English company which acted as a trustee of the shares. These shares were held as security for the debt owed to the respondent. There were a number of different agreements entered into. It is not, however, relevant to tediously itemise each one. Part of the arrangement between the various entities was that a company be incorporated in South Africa. The Dutch company transferred all its interests together with all its liabilities to the South African company that had been formed at the instance of the respondent. The respondent did this due to a fear of invasion and, therefore, loss of the Dutch company’s obligation.²⁹³ The result was that the company incorporated in South Africa was now responsible for the interest payments. Such payments, for the years in question, were made from the company’s dividends it received from the American shares

²⁹⁰ Williams *Income Tax in South Africa Cases and Materials* 18.

²⁹¹ 14 SATC 1.

²⁹² *CIR v Lever Brothers and Unilever* 4.

²⁹³ *CIR v Lever Brothers and Unilever* 7.

it held. The Commissioner contended, on the basis of these facts, that the source of the interest payments received by respondent was South African and should, thus, be taxed. This contention was, essentially, based on the fact that a debt is regarded in law – according to the Commissioner – as located where the debtor resides. Since the debtor was the company which had been formed and incorporated in South Africa the debt was to be located in South Africa.²⁹⁴ This contention was, eventually, disposed of – not, however, without conjecture.

It was stated in the introduction to this chapter that this case provided a particularly good example of Watermeyer’s lucid, clear and comprehensible style of judgment. This is immediately evident after outlining the facts where he explained what is meant by a ‘debt.’²⁹⁵ He appeared to embark on lecture-like explanation of this meaning by stating that:

A debt is a legal obligation, something having no corporeal existence; consequently it can have no real and actual situation in the material world. Metaphorically, however, by legal fiction it may have a situation in a place, determined by accepted legal rules.²⁹⁶

It will be remembered from chapter two that a legal fiction is a device used in many branches of law to simplify difficult phenomena. After stating that the word ‘source’ as it appears in the Act is metaphorical in nature and, as such, requires determining he went on to state that:

When the question has to be decided whether or not money received by a taxpayer is “gross income” within the meaning of the definition referred to above, two problems arise which have not always been differentiated from one another in decided cases. The first problem is to determine what is the source from which it has been received and when that has been determined the second problem is to locate it in order to decide whether it is or is not within the Union.²⁹⁷

²⁹⁴ *CIR v Lever Brothers and Unilever* 7.

²⁹⁵ *CIR v Lever Brothers and Unilever* 8.

²⁹⁶ *CIR v Lever Brothers and Unilever* 8.

²⁹⁷ *CIR v Lever Brothers and Unilever* 8.

The first quote above provides us with evidence of the understandable nature of his style of delivering judgments. Without explaining the basic concept of what constitutes a 'debt' the rest of the judgment would have been significantly more difficult to follow and understand. The second quote provides us with evidence of the clarity of reasoning which he intended to convey. He specifically made reference to the fact that other courts had not always been clear on the fact that there exists a two pronged enquiry when it came to source issues. His clear differentiation of the two problems contributed to the understandable or readable nature of this judgment. Significantly, he went on to state that the "word source has several possible meanings."²⁹⁸ It is necessary to pause at this moment and cast one's mind back to chapter two where the literal theory of interpretation was discussed. It was stated in the relevant section that literalists are of the belief that each provision can be accorded an ordinary, grammatical meaning. Not so, according to Watermeyer, with respect to the word 'source.' No one grammatical meaning exists for the word. He, in fact, stated that there are "several" possibilities which is implicit recognition of the fact that the meaning of the word needs to be determined in context. Once again it must be noted that contextualism is a friend of purposivism. Directly after pointing out the multitude of meanings that could be assigned to source Watermeyer stated with respect to the word 'source' that:

In this section it is used figuratively, and when so used in relation to the receipt of money one possible meaning is the originating cause of the receipt of the money, another possible meaning is the quarter from which it is received. A series of decisions of this Court and of the Judicial Committee of the Privy Council upon our Income Tax Acts and upon similar Acts elsewhere have dealt with the meaning of the word "source" and the inference, which, I think, should be drawn from these decisions is that the source of receipts, received as income, is not the quarter from whence they come, but the originating cause of their being received as income and that this originating cause is the work which the taxpayer does to earn them, the *quid pro quo* which he gives in return for which he receives them. The work he does may be a business which he carries on, or an enterprise which he undertakes, or an activity in which he engages and it may take the form of personal exertion, mental or physical, or it may take the form of employment of capital either by using it to earn income or by letting its use to someone else. Often the work is a combination of these.²⁹⁹

²⁹⁸ *CIR v Lever Brothers and Unilever* 8.

²⁹⁹ *CIR v Lever Brothers and Unilever* 8.

De Koker and Williams quote this entire passage together with the previous one dealing with the two pronged test. They make it clear that these two passages are unquestionably the leading authority on the interpretation of the word ‘source’ as it appears in the definition of gross income.³⁰⁰ Subsequent to his statement of the above law, Watermeyer went on to draw an analogy between the lending of money and the renting of property. In order for the reader to appreciate the quality of the logic employed and the comprehensible nature of the analogy, the passage must be quoted directly. The following was stated in this regard:

In a letting and hiring of property the ownership of the property never passes and it has to be restored to the owner at the end of the lease; in a loan of money on the other hand the same money need not be returned. Although the same money need not be returned, the same amount, as a rule, must be repaid. The difference does not affect the analogy which I am drawing. Each contract imposes a debt or obligation, in the one case on the borrower, in the other case on the lessor, to return something (money or property) to the lender or lessor at the end of agreed period. Now the “debt”, which it is argued is the source of the interest on a loan, is this legal obligation resting on the borrower to repay the loan at the end of the agreed period. If the argument that the debt is the source of the interest which is received as income were sound it would follow by parity of reasoning that the obligation on a lessee to redeliver the leased premises would be the source of rent received by a lessor as income. Such a conclusion has only to be stated to refute itself and its statement shews to what surprising results the use of figurative language in a real problem may lead.³⁰¹

The reason the statement needs only to be stated to be refuted is due to the fact that the obligation on a lessee to return the property would never be labelled the source of rental income. The property itself would obviously be the ‘source’ of the income.³⁰² In other words the source of the income is not the obligation itself. How the obligation came about is regarded as the source. In this case the obligation to pay interest originated or came about outside of South Africa through a multitude of agreements – none of which took place in South Africa. This analogy makes the judgment delivered extremely comprehensible and understandable due to the fact that it established a link between technical law and the practical application thereof through the use of an example.

³⁰⁰ De Koker and Williams *Silke on South African Income Tax* para 5.3.

³⁰¹ *CIR v Lever Brothers and Unilever* 8.

³⁰² *COT v British United Shoe Machinery* 26 SATC 163.

Evidence of his lecture-like manner in delivering judgments is also made clear by his explanation of basic concepts in the above analogy. It is submitted, also, that it makes the dissenting judgment delivered by Schreiner JA appear weak. This judgment will be briefly discussed below in order to illustrate the different reasoning employed by the learned judges. After demonstrating the above absurdity – with reference to the house-letting example – that may occur if ‘figurative language’³⁰³ is used in a real problem, he went on to survey a vast quantity of authority on the matter. It is interesting to note briefly that a synonym for figurative language is non-literal. It is submitted that where Watermeyer has suggested that figurative language has been employed in the legislation he is, essentially, stating that a literal approach is unworkable. This provides further evidence of his non-literalist tendencies.

He went on to consider no less than four Privy Council decisions on the meaning to be ascribed to ‘source’ in various taxing statutes. He regarded the most important of these decisions to be the case of *Lovell & Christmas v Commissioner of Taxes*³⁰⁴ where Sir Arthur Wilson held that:

The trade or business in question ... ordinarily consists in making certain classes of contracts and in carrying those contracts into operation with a view to profit; and the rule seems to be that where such contracts, forming, as they do, the essence of the business or trade, are habitually made there a trade or business is carried on within the meaning of the Income Tax Act.³⁰⁵

Two Appellate Division cases were referred to thereafter – both of which involved the great Innes CJ. With reference to Australian tax academics Innes CJ put forward – albeit tentatively – that the word ‘source’ does not denote location but rather origin. An Australian tax academic by the name of Menzies Murray was quoted by Innes CJ as stating that:

³⁰³ *CIR v Lever Brothers and Unilever* 9.

³⁰⁴ 1907 AC 46.

³⁰⁵ *CIR v Lever Brothers and Unilever* 11.

... the source of any income may be said generally to be *the location of* the business, capital, or service which produces the income (own emphasis).³⁰⁶

Watermeyer in demonstrating his outstanding attention to detail went on to criticise this statement by stating that it would have been far more accurate had the words “the location of” not been included. He was, essentially, making reference to the fact that in determining the source of income one is primarily concerned with the originating cause thereof. In other words location is not the primary concern. The “activity of the taxpayer which earns the money”³⁰⁷ is. Only once this has been determined does location become important. This is in terms of the two pronged enquiry established above. Further case law on the matter was thereafter referred to. The only particularly significant case was the Australian case of *Nathan v Federal Commissioner of Taxes*³⁰⁸ where the following was stated by Isaacs J with respect to the meaning of ‘source:’

Source means not a legal concept but something which the practical man would regard as a real source of income. The ascertaining of the actual source is a practical hard matter of fact.³⁰⁹

Isaacs J appeared to be simply stating that the determination of source is an exercise in logic and fact rather than a technical issue. Acceptance of this statement was – albeit implicitly – made in Watermeyer’s closing paragraph in his judgment. It is submitted that the logical, comprehensible and understandable nature of this approach appealed to Watermeyer’s sense or method of reasoning. Watermeyer’s reference to the considerable quantity of authority quoted above provides more evidence of Watermeyer’s relentlessly enquiring nature. Evidence of his appetite for flawlessness in both research and outcome was once again made clear. The only remaining issue to be dealt with was the application of the applicable law to the actual facts of the matter.

The various agreements entered into were all concluded outside of South Africa.³¹⁰ Furthermore, no business or other activity was carried on within South Africa by the

³⁰⁶ *CIR v Lever Brothers and Unilever* 12.

³⁰⁷ *CIR v Lever Brothers and Unilever* 12.

³⁰⁸ 25 CLR 183.

³⁰⁹ *Williams Income Tax in South Africa Cases and Materials* 21.

respondent. The only fact tying the interest income to South Africa was the fact that the respondent's debtor was incorporated in South Africa. This was held by Watermeyer, however, to be insufficient to warrant a finding to the extent that the source of respondent's income was South African.³¹¹ The following quotation provides an excellently articulate conclusion that puts any lingering doubts on the matter to rest. The analogy between letting a house and paying back a debt made earlier should be borne in mind. Watermeyer stated in this regard that:

... the mere existence of the debt did not entitle the taxpayer to receive money from Overseas Holding; it was the agreement between the parties that interest should be paid, and the performance by Levers of their obligations under it, which created the right of Levers to receive the money and the corresponding obligation of Overseas Holding to pay it. So it could more properly be said that it was the making and carrying out of the agreement relating to the £11 000000 by the taxpayer, which earned the income for him, rather than the existence of the debt resulting from that agreement.³¹²

Simply put, it was the entering into and negotiating of agreements that resulted in the income. These agreements were the source of the income. The debt was a necessary consequence of these agreements but it was by no means the source of income. The Commissioner was, therefore, unsuccessful. It is interesting to note that the issue of apportionment of source and whether this is, indeed, acceptable remains uncertain.³¹³ This judgment provides what could be described as the early beginnings of this still unclear point of law. Evidence of this is provided where Watermeyer stated that:

Such a state of affairs may lead to the conclusion that the whole receipt, *or part of it*, or none of it is taxable as income from a source within the Union, according to the particular circumstances of the case, but I am not aware of any decision which has laid down clearly what would be the governing consideration in such a case. (Own emphasis).³¹⁴

³¹⁰ *CIR v Lever Brothers and Unilever* 14.

³¹¹ *CIR v Lever Brothers and Unilever* 14.

³¹² *CIR v Lever Brothers and Unilever* 14.

³¹³ *Williams Income Tax in South Africa Cases and Materials* 25-27, De Koker and Williams *Silke on South African Income Tax* para 5.4 and Huxham and Haupt *Notes on South African Income Tax* 30.

³¹⁴ *CIR v Lever Brothers and Unilever* 10.

No court has, as yet, laid down any governing considerations to this extent and the above quotation is merely *obiter*. It is quite interesting, however, to note that De Koker and Williams, while acknowledging that no court has laid down any binding rules, appear to have accepted Watermeyer's *obiter* remark as the most acceptable statement of the applicable law with respect to apportionment.³¹⁵ It is, therefore, suggested that this *obiter* remark remains the leading authority on the issue of whether apportionment of source is permissible. This is quite a remarkable feat given the fact that apportionment of source was not even argued in the *Lever Bro's* case. The dissenting judgment of Schreiner JA will be discussed next in order to highlight by means of comparison the remarkably lucid and able argument delivered by Watermeyer.

It should be noted that the enactment of sections 9(6) and (7) of the Act has, in limited circumstances, overruled the source principle developed by Watermeyer.³¹⁶ A discussion of the application of these sections is, however, beyond the scope of this thesis.

4.3.1 Dissenting Schreiner vs Watermeyer: A brief analysis

Schreiner JA, whilst setting out the law in reasonably similar terms to Watermeyer, nevertheless, managed to come to a different conclusion.³¹⁷ The vital distinction between the judgments seems to have been the relevance attached to the various agreements entered into by the respondent. Whilst Watermeyer held the place where these agreements were entered into to be of vital significance, Schreiner JA held them to be "irrelevant."³¹⁸ In other words Watermeyer came to the conclusion that the agreements whereby the debt was incurred should be regarded as the source of respondent's income. Schreiner JA took the position, based on the case of *English, Scottish and Australian Bank Ltd v CIR*³¹⁹ that the debt "exists where the debtor resides."³²⁰ It is tentatively submitted that this is the more practical approach in terms of a lay person's understanding

³¹⁵ De Koker and Williams *Silke on South African Income Tax* para 5.4.

³¹⁶ Act 58 of 1962.

³¹⁷ De Koker and Williams *Silke on South African Income Tax* para 5.3, *CIR v Lever Brothers and Unilever* 24.

³¹⁸ *CIR v Lever Brothers and Unilever* 14.

³¹⁹ 1932 AC 238.

³²⁰ *CIR v Lever Brothers and Unilever Ltd* 21.

of the matter. It is, however, also submitted that the judgment and conclusion of Watermeyer is far more legally sound. His reasoning is more coherent and his use of the analogy involving a lease seems to put his argument beyond any real doubt. Watermeyer through this analogy, essentially, concluded that that it is the provision of credit that is the ‘originating cause’ of the income just as the provision of the property would be the ‘source’ of any lease payments. The provision of the credit was concluded in terms of the negotiated agreements entered into outside of South Africa. It, therefore, followed that the interest received by the respondent was not of a South African source.

Once Schreiner JA accepted the legal fiction that a debt exists where the debtor resides³²¹ there was little prospect of a ruling in favour of the taxpayer. The learned judge was, with respect, unable to come to terms with the fact that more is required in order to determine the real source of income. In other words more exploration is required in order to determine the originating cause of the income. The debt, as it existed in terms of the company incorporated in South Africa could, surely, never be described as the originating cause of the interest received by the respondent. The exhaustive analysis conducted by Watermeyer with respect to his excellent use of analogy as well as his reference to a vast array of authority is conspicuously absent from the judgment of the learned Schreiner JA. The following section will, furthermore, detail how Schreiner JA, in subsequent cases dealing with the interpretation of the word source, quoted directly from Watermeyer’s judgment and, interestingly, not from his own. Obviously, however, the principle of *stare decisis* must be borne in mind.

4.3.2 Application and use of the *Lever Brothers* principle

It has already been stated that this case is unquestionably the leading authority on the matter and is inevitably referred to in any case dealing with the interpretation of the word source as it appears in the definition of gross income in section 1. It is interesting to note that eight years after the *Lever Brothers* decision was delivered the Appellate Division had occasion once more to interpret the meaning of the word source so used in the case of

³²¹ *CIR v Lever Brothers and Unilever Ltd* 21.

CIR v Epstein.³²² Schreiner JA was once again involved in a dissenting capacity – this time, however, in favour of the taxpayer. The taxpayer in the case of *Epstein* carried on business in a partnership. The taxpayer’s business partner was based in Argentina and the taxpayer in South Africa. The Argentinean partner sourced customers for which the taxpayer was asked to approach the designated supplier in South Africa and arrange the required quality and quantity of asbestos. The supplier was designated by the Argentinean partner. A final sale was thereafter concluded in Argentina whereafter the asbestos was shipped to Argentina.³²³ The Commissioner assessed the taxpayer’s profits to which the taxpayer objected, claiming that the income derived from such sales were received from a source without South Africa. It must be remembered that South Africa, at the time of this decision, operated a source-based approach to taxation.

Having dissented in the *Lever Brothers* decision only eight years earlier, it is quite striking that Schreiner JA chose to adopt, as the basis of his judgment, the following statement delivered by Watermeyer in the *Lever Brothers* decision with respect to the interpretation of the word ‘source’ to the extent that:

the source of receipts, received as income, is not the quarter whence they come, but the originating cause of their being received as income.³²⁴

Schreiner JA, at no stage, referred to his own judgment delivered in the *Lever Brothers* case. Whilst it is acknowledged that Schreiner JA was bound by Watermeyer’s interpretation, it must also be mentioned that where a judge thinks a binding precedent is clearly wrong he may depart from it. Dissenting judgments are, furthermore, still capable of persuasive force. Both judges did, however, state the law in similar terms in the *Lever Bro’s* decision which makes Schreiner JA’s reference to only the Watermeyer judgment even more intriguing. In other words, technically, Schreiner JA may have referred to his own dissenting judgment – but chose not to do so. Towards the end of the *Epstein* judgment Schreiner JA once again made authoritative reference to Watermeyer and even

³²² 19 SATC 221.

³²³ *CIR v Epstein* 226-229.

³²⁴ *CIR v Epstein* 233.

made use of Watermeyer's exact phraseology.³²⁵ Schreiner JA came to the conclusion that the taxpayer had not received the income in question from a source within South Africa and dismissed the Commissioner's appeal. The 'originating cause' of the income, according to Schreiner JA, was where the sale took place.³²⁶ The rest of the court, however, concluded that the income was received from a source in South Africa. The correctness or otherwise of the outcome of this case is not important for current purposes. The *Epstein* judgment highlights the immediate impact of the *Lever Brothers* decision in that both the majority judgment and, more interestingly, the dissenting judgment referred authoritatively to it. The case of *CIR v Black*³²⁷ is once again indicative of Watermeyer's contribution in terms of the interpretation of the word 'source' as used in the definition of gross income. Justice Schreiner, in his capacity as acting Chief Justice, wrote the majority judgment with which the rest of the bench concurred. The facts of the case are not important. It is interesting to note that only three decisions were referred to in his judgment – one of which was Watermeyer's *Lever Brothers* decision and the other being the *Epstein* case which referred authoritatively to Watermeyer's *Lever Brothers* decision. The only other decision referred to was a foreign judgment. The *Black* decision was delivered only eleven years after *Lever Brothers* by which stage it was already clear that Watermeyer's judgment in the *Lever Brothers* decision was the fundamental authority with respect to the interpretation of 'source' in the definition of gross income.

The 1967 case of *Transvaal Associated Hide and Skin Merchants v Collector of Income Tax*³²⁸ is instructive with regard to the wide acceptance of Watermeyer's *Lever Bro*'s judgment. Roper P when referring to the applicable legal principles with respect to the interpretation of 'source' stated that:

In *C.I.R. v Lever Brothers*, 1946 A.D. 441, in a passage which has *often been quoted and which is not necessary to repeat*, Watermeyer C.J., after a review of the authorities, expressed the view that the source of receipts of income was not the quarter whence they came, but the originating cause of their being received as income, and that this originating cause was the *quid pro quo* which the taxpayer gave in return

³²⁵ *CIR v Epstein* 237.

³²⁶ *CIR v Epstein* 237.

³²⁷ 21 SATC 226.

³²⁸ 29 SATC 97.

for which he received them. In a later passage he said that the source of income was the business, capital, or service which was responsible for the earning of it. This definition of ‘source’ is *generally accepted* ... (own emphasis).³²⁹

Although this case was heard in Botswana’s Court of Appeal the legislation in question was materially the same as its South African counterpart. By 1967 it is, therefore, fair to say that the *Lever Brothers* decision was, without question, the leading authority on the matter. This was once again reaffirmed in the case of *ITC 1491*,³³⁰ heard in 1990, where Kroon J quoted the famous passage delivered by Watermeyer in *Lever Brothers* as the starting point of his judgment with respect to the source of particular income. Kroon J stated that the relevant passage was instructive as to the correct approach to be adopted.³³¹

The recent unreported judgment of *First National Bank v CIR*,³³² heard in 2002, referred authoritatively to the *Lever Brothers* decision as accepted and reaffirmed by Corbett CJ in the case of *Essential Sterolin Products v CIR*.³³³ The *First National Bank* case (hereafter referred to as the ‘FNB case’) was concerned with transactions during 1987 and 1988. As such the fact that our system had changed to a residence-based system when it was heard was irrelevant. The case dealt with the provision of credit to the taxpayer’s South African clients in New York through a different bank in New York with which the taxpayer had a foreign exchange agreement. The name of the Bank through which appellant operated was the Chase Manhattan Bank. Appellant’s argument was, essentially, that:

in our law the source of interest is determined by the place where the funds which attracted the interest are made available to the borrower. As this occurred in New York the source of the appellant’s interest was located outside the Republic and was therefore excluded from its gross income.³³⁴

³²⁹ *Transvaal Associated Hide and Skin Merchants v Collector of Income Tax* 102.

³³⁰ 53 SATC 115.

³³¹ *ITC 1491* 122.

³³² Unreported 343/2000 SCA.

³³³ 1993 (4) SA 859 (A).

³³⁴ *First National Bank v CIR* para 11.

The appellant relied on the *Lever Brothers* case in order to justify the above, seemingly simplistic, argument. Smalberger ADP, who wrote the judgment of the court, after articulating the appellant's argument, went on to examine the applicable legal principles. He referred immediately to the more recent case of *Essential Sterolin Products* where Corbett CJ expounded the applicable law with respect to the interpretation of the word source. Corbett CJ referred first to the *Lever Bro's* decision, implicitly accepting that decision as fundamental authority on the matter, after which he proceeded to extract Watermeyer's famous passage as quoted above and in several tax publications.³³⁵ Smalberger ADP, after quoting Corbett CJ's recognition of the *Lever Brothers* dictum, affirmed that:

No substantial or persuasive challenge was directed against the applicability of these principles in the present appeal. Nor was it suggested that there might be special cases falling beyond the principles enunciated.³³⁶

Since Corbett CJ accepted the *Lever Brothers* principle as fundamental authority on the matter and no challenge was launched against the principles enunciated in the *Essential Sterolin Products* case, it follows that Watermeyer's *Lever Brothers* decision remains the most pervasive authority on the issue of source. This has already been unquestionably highlighted in terms of tax publications. It is, however, more important to determine that the courts, themselves, view it as the fundamental authority as textbooks provide us only with secondary sources whereas judgments are primary sources of law. It was also suggested – as outlined in the above quotation – that there are no special cases falling outside of the principles enunciated. This provides us with evidence of the diversity of Watermeyer's pronouncement on the interpretation of source. In other words even though novel situations may arise that were not in contemplation at the time of Watermeyer's interpretation of the word 'source,' such interpretation is still considered and, indeed, is the primary reference. Smalberger ADP went on to give a brief summation of the facts in the *Lever Brothers* case after which he directly quoted

³³⁵ *First National Bank v CIR* para 12, De Koker and Williams *Silke on South African Income Tax* para 5.3, *Williams Income Tax in South Africa Cases and Materials* 25-27 and Huxham and Haupt *Notes on South African Income Tax* 29.

³³⁶ *First National Bank v CIR* para 13.

Watermeyer's two pronged test³³⁷ which has already been quoted above on page 75. Smalberger ADP quoted various Watermeyer statements including the following one where it was stated that the supply of credit:

... is the service which the lender performs for the borrower, in return for which the borrower pays him interest. Consequently, this *provision of credit* is the originating cause or source of the interest received by the lender ... the borrower pays interest ... as consideration for the benefits allowed to him by the lender (own emphasis).³³⁸

The taxpayer's argument was, essentially, based on this statement. Smalberger ADP, quite rightly, however, was not convinced that Watermeyer intended such a narrow reading to be made of his judgment. Evidence of this was Watermeyer's detailed scrutiny of the transactions involved. If he had intended such a narrow precedent to be established it was the opinion of Smalberger ADP that such a detailed scrutiny would not have been necessary.³³⁹ It is submitted that this was the correct approach to be taken to the *Lever Brothers* decision. General principles were laid down and, it is evident, furthermore, that Watermeyer was of the opinion that each case is, ultimately, dependant on the actual facts of the matter. Evidence of this submission is established in terms of Watermeyer's implicit adoption of the following statement:

Source means not a legal concept but something which the practical man would regard as a real source of income. The ascertaining of the actual source is a practical hard *matter of fact* (own emphasis).³⁴⁰

This statement was adopted from the Australian case of *Nathan v Federal Commissioner of Taxation*.³⁴¹ In other words each case needs to be determined on the basis of its unique facts. The facts of *First National Bank* as opposed to *Lever Brothers* were not particularly analogous and Smalberger ADP was of the opinion that they were materially different.³⁴² After rejecting the narrow formulation of Watermeyer's *dicta* attempted by

³³⁷ *First National Bank v CIR* para 14.

³³⁸ *First National Bank v CIR* para 16.

³³⁹ *First National Bank v CIR* para 18.

³⁴⁰ *CIR v Lever Brothers and Unilever Ltd* 13, *First National Bank v CIR* para 17.

³⁴¹ 25 CLR 183.

³⁴² *First National Bank v CIR* para 17.

the taxpayer Smalberger ADP carried on to hold against the taxpayer by stating that the narrow view:

... overlooks the need to have regard to the *essence of the whole transaction* which generated the interest with a view to determining the location of its source (own emphasis).³⁴³

Smalberger ADP did not doubt the correctness of the *Lever Brothers* decision. This is implicitly evident when one considers his earlier reference to Watermeyer’s scrutiny of all the various agreements and transactions involved. In other words Watermeyer analysed the “essence of the whole transaction.” The provision of credit will not necessarily be the source of interest income in every case. The ascertainment of source according to Watermeyer is a “practical hard matter of fact.” It has been highlighted above that while there are other cases which can be referred to when dealing with the interpretation of source, the judgment delivered by Watermeyer in the *Lever Brothers* decision is considered – always – to be the basis for such an exploration. The next section will provide a brief summation of the overall contributions made by Watermeyer with respect to the *Lever Brothers* case.

4.3.3 Conclusion and summary of Watermeyer’s *Lever Brothers* contributions

The acceptance of this judgment as the leading authority on the interpretation of the word source as it appears in the definition of gross income is beyond doubt. This is highlighted by both the courts – as discussed in the previous section – and tax publications alike. More interesting, however, is the manner in which the judgment is delivered. His lecture-like approach to the explanation of basic legal concepts as well as his use of analogy was masterful. Without these features it is submitted that the judgment may not have made as significant an impact. These features undoubtedly contributed to the understandable and lucid nature of the decision. It is also particularly clear from this judgment that Watermeyer was not of the literalist school of statutory interpretation. Apart from making express reference to the fact that the word ‘source’ as it appeared in

³⁴³ *First National Bank v CIR* para 17.

the definition of gross income was capable of several meanings, he also referred to the use of “figurative language” which is, as was stated above, a synonym for non-literal. The fact that the word source was capable of several meanings in Watermeyer’s mind was, most certainly, implicit recognition of the fact that it had to be interpreted in context.

Watermeyer referred, also, to an abundance of authority on the matter – both local and foreign. This was suggested as constituting evidence of his enquiring nature and relentless search for flawlessness in both research and outcome. His attention to detail was also highlighted where he criticised a particular statement to the extent that it included three unnecessary words. The issue of apportionment of source was also briefly alluded to. It was submitted, with reference to De Koker and Williams, that Watermeyer’s *obiter* remark with respect to apportionment remains the leading statement as to whether the apportionment of source is, legally, acceptable. This point remains unclear in our law. Schreiner JA’s dissenting judgment was compared to Watermeyer’s judgment. While it was suggested that, perhaps, Schreiner JA’s approach may appeal to the lay person, it was also submitted that Watermeyer’s judgment was far more thorough and legally sound. It was put forward that Watermeyer’s use of the rental analogy put the argument beyond doubt and cast a shadow over the soundness of Schreiner JA’s judgment. Watermeyer’s judgment remains vital to non-residents generating income in South Africa and will continue to be the leading principle on the interpretation of source as it relates to non-residents. It was stated in the introduction that Watermeyer’s *Lever Brothers* decision was a particularly good example of Watermeyer’s lucid, clear and comprehensible approach to delivering judgments. It is submitted that the above analysis of this judgment has given credence to this statement. The following case that will be analysed has been recognised as Watermeyer’s leading and most often referred to achievement.³⁴⁴ This is quite extraordinary when one considers the contributions made by Watermeyer up to this point.

4.4 Capital, revenue and New State Areas

³⁴⁴ Wright 2009 *Tax Planning* 96.

The facts of *New State Areas v CIR*³⁴⁵ are reasonably simple and provide a neat illustration of the principle established in this case. The taxpayer was in the business of gold mining. Subsequent to a ruling by the local municipality, the appellant was required to install a water-borne system of sewage in order to replace the so-called ‘bucket system.’ Had appellant not complied with the municipal ruling it would not have been able to continue operating. It was required to install a system of internal sewage works to be connected to the main sewage system which was external to its property. By internal sewage works it is meant sewage works on the property of the appellant. The sewage systems – both external and internal – were constructed by the local council. The appellant could have insisted on constructing the internal system. It chose, however, not to do so. There were different charges levied by the municipality with respect to the internal and external systems. The internal system was to be paid off in sixty monthly instalments after which it was to become the property of the mine. It was akin, in other words, to paying off, by instalment, any other construction that may have taken place on the appellant’s property. The charges levied with respect to the external system were to be paid over three hundred instalments after which the system was to remain the property of the local council. The vital distinction between the internal and external systems was, therefore, the issue of ownership. Ownership was never acquired with respect to the external system while ownership was acquired after just five years with respect to the internal system.³⁴⁶ The instalment expenditure for both the external system and the internal system was deducted by the taxpayer for the relevant years of assessment. The Commissioner declined, however, to permit these deductions on the basis that the expenditure was of a capital nature and, in terms of section 11(2)(a), not, therefore, deductible.³⁴⁷ Both the Special Court and the Transvaal Provincial Division agreed with the Commissioner to the extent that the deductions claimed were of a capital nature and, therefore, not deductible.³⁴⁸ The appellant, therefore, appealed to the Appellate Division against the Provincial Division’s finding that, although the expenditure in question was incurred in the production of income, it was capital in nature.

³⁴⁵ 14 SATC 155.

³⁴⁶ *New State Areas v CIR* 157-158.

³⁴⁷ *New State Areas v CIR* 162.

³⁴⁸ *New State Areas v CIR* 162.

After setting out the general deduction formula in terms of section 11(2)(a) and section 12(g) as it then was, Watermeyer referred to his *PE Electric* judgment which was (and still is) regarded as the *locus classicus* on what constitutes deductible expenditure. In explaining what constitutes deductible expenditure Watermeyer stated – with direct reference to *PE Electric* – that:

... in a literal sense expenditure and losses do not produce income. Save in the case of the leasing or the 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 income but the former is, as a rule, current or revenue expenditure, and the latter is, as a rule, expenditure of a capital nature. As to the latter the distinction must be remembered between floating or circulating and fixed capital. When the capital employed in a business is frequently changing its form from money to goods and *vice versa* (e.g. the purchase and sale of stock by a merchant or the purchase of raw material by manufacturer for the purpose of conversion to a manufactured article) and this is done for the purpose of making a profit, then the capital so employed is floating capital. The expenditure of a capital nature, the deduction of which is prohibited under sec 11(2), is expenditure of a fixed capital nature, not expenditure of a floating capital nature, because expenditure which constitutes the use of floating capital for the purpose of earning a profit, such as the purchase price of stock in trade, must necessarily be deducted from the proceeds of the sale of stock in trade in order to arrive at the taxable income derived by the taxpayer from that trade.³⁴⁹

This passage is extremely useful in that it offers a base or guideline from which to work when dealing with the determination of the nature of an expense. The term ‘capital nature’ is not defined in the Act and requires, therefore, recourse to case law. Two features of previous judgments discussed are immediately evident. The first is the lecture-like manner employed by Watermeyer in order to convey, in the clearest possible terms, what he was arguing. The second is his excellent use of examples in order to elucidate the point he was making. It was suggested earlier that such examples provide the reader of the judgment with an illustration from which point it is easier to make the

³⁴⁹ *New State Areas v CIR* 163-164.

connection between technical and practical law. The distinction between floating capital and fixed capital could easily be confused without the use of practical examples being employed. It is, furthermore, noteworthy that Watermeyer in making the above statement drew heavily on his *PE Electric* decision, made some ten years previously. This could, possibly, be viewed as evidence of judicial continuity or consistency. The quotation also made it very clear that both capital and revenue expenditure may be incurred in the production of income. Because expenditure has been incurred in the production of income and, furthermore, satisfies the negative requirement of the general deduction formula (section 23(g)), does not, necessarily, mean it is deductible. It is submitted that this point was stressed due to the possible confusion that may have resulted. In other words it is very possible that if an expense satisfies all the criterion of the general deduction formula; the fact that it is of a capital nature could very well be overlooked.

A common problem, according to Watermeyer, was (and still is) determining the difference between expenditure incurred “as part of the cost of performing the income-earning operations”³⁵⁰ and expenditure aimed at “establishing or improving or adding to the income-earning plant or machinery.”³⁵¹ A leading judgment on the issue of whether expenditure is of a capital or revenue nature was delivered by Innes CJ in the case of *CIR v George Forest Timber*.³⁵² This was referred to by Watermeyer who quoted the following passage by Innes CJ with approval:

In the absence of any authoritative and comprehensive definition of capital expenditure it is well to bear in mind the characteristic quality of capital; that it is wealth employed in creating fresh wealth, invested to produce income. As already pointed out, the proceeds of merchandise sold in the course of trade are included in the gross income of the trade, because they are not receipts of a capital nature, within the meaning of sec 6. Similarly, the cost of merchandise thus disposed of would be an outgoing and not of a capital nature within the meaning of sec 17 (1) (a); and having been incurred in producing the income would be properly deducted under that clause.

³⁵⁰ *New State Areas v CIR* 164.

³⁵¹ *New State Areas v CIR* 164.

³⁵² 1 SATC 20.

Now, money spent in creating or acquiring an income-producing concern must be capital expenditure. It is invested to yield future profit; and while the outlay does not recur the income does. There is a great difference between money spent in creating or acquiring a source of profit, and money spent working it. The one is capital expenditure, the other is not. The reason is plain; in the one case it is spent to enable the concern to yield profits in the future, in the other it is spent in working the concern for the present production of profit.³⁵³

This passage is also of significant assistance in determining the nature of a particular expense. The passage refers to the fact that capital expenditure is spent to yield future profits while revenue expenditure is spent on present production. Watermeyer, after highlighting the fact that many cases which involved the issue under consideration were “borderline,”³⁵⁴ embarked on an analysis of English authority on the matter and the various tests that have been developed by the English courts. The first test referred to was the so-called ‘once and for all’ test. This was an early test developed in the case of *Vallambrosa Rubber Co v Farmer*³⁵⁵ which essentially stated that where an expense is incurred and paid once and for all it is capital in nature as opposed to recurrent expenditure which is revenue in nature. Watermeyer was not persuaded that such a test warranted much validity and he referred to the fact that subsequent English decisions were implicit of the same tentativeness.³⁵⁶ The English courts subsequent to the *Vallambrosa* case were more concerned with the “true character of the transaction” as opposed to its form.³⁵⁷

The highly influential English case of *British Insulated Helsby Cables v Atherton*³⁵⁸ was extensively referred to by Watermeyer. The *dicta* in this judgment recognised that while the ‘once and for all’ test is a factor to be considered, it is by no means conclusive. The following passage offered by Lord Cave formulated what is now known as the ‘enduring benefit’ test and reads as follows:

³⁵³ *New State Areas v CIR* 164.

³⁵⁴ *New State Areas v CIR* 165.

³⁵⁵ 1910 S.C. 519.

³⁵⁶ *New State Areas v CIR* 165.

³⁵⁷ *New State Areas v CIR* 165.

³⁵⁸ 1926 A.C. 205.

But when an expenditure is made not only once and for all, but with a view to bringing into existence an asset or advantage for the *enduring benefit* of a trade, I think that there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital (own emphasis).³⁵⁹

This passage, it is submitted, gives a more lucid explanation of what might constitute capital expenditure as compared to the passage quoted earlier offered by Innes CJ in the case of *George Forest Timber*. Innes CJ appears to have applied a narrower formulation of determining whether expenditure is capital in nature. This is because he stated that an expense is capital in nature if it is intended to yield profits in the future. Lord Cave, on the other hand, did not specifically refer to profits but rather to the broader term ‘trade.’ This is a more satisfying test. The implementation of the sewage works on the appellant’s property can hardly be said to have contributed to the yielding of future profits. It is far more precise to state that the sewage works on appellant’s property brought into ‘existence an asset or advantage for the enduring benefit’ of its trade. It should also be noted with respect to Lord Cave and the quoted passage above that expenditure incurred ‘with a view’ to creating an asset or advantage is also capital in nature. In other words the expenditure will still be classified as capital in nature even if it does not have the result of creating an asset or advantage.³⁶⁰

After quoting extensively from the judgment of Lord Cave delivered in the case of *Atherton*, Watermeyer referred to another English case which extended the *dicta* of Lord Cave. Romer LJ in the case of *Anglo-Persian Oil v Dale*³⁶¹ approved of the ‘enduring benefit’ test but extended it by stating that by ‘enduring’ it is meant “enduring in the way that fixed capital endures.”³⁶² This modification was made in light of the possible confusion that may arise between floating capital and fixed capital. The difference between fixed and floating capital was explained – as quoted above – earlier in Watermeyer’s judgment. Watermeyer, in pursuit of clarity and comprehensibility, delineated the tests as developed by the English courts and linked them to South African

³⁵⁹ *New State Areas v CIR* 165.

³⁶⁰ *New State Areas v CIR* 166.

³⁶¹ 1932 1 K.B.D. 124.

³⁶² *New State Areas v CIR* 168.

authority on the matter. After a careful consideration and scrutiny of both domestic and foreign case law Watermeyer stated that:

The conclusion to be drawn from all of these 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. Its true nature is a matter of fact and the purpose of the expenditure is an 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.³⁶³

This statement of the law with regard to the difference between capital and revenue expenditure is now regarded as the *locus classicus* on the matter. It is submitted that the exceptionally well-rounded and well-structured examination of the salient issues and available authority contributed towards the *New State Areas* judgment becoming the primary authority or reference when determining the difference between capital and revenue expenditure. De Koker and Williams quote the above passage at the beginning of their section on what constitutes capital expenditure.³⁶⁴ *New State Areas* is, therefore, evidently, the starting point for any argument involving the difference between capital and revenue expenditure. Other major reference books also quote the same *dicta* directly from Watermeyer.³⁶⁵ The courts, as will be highlighted below, have also embraced the above passage as a correct and commendable statement of the law. In applying the legal principles discussed above Watermeyer concluded that the internal system of sewage was of a capital nature. The fact that such expenditure was forced upon the appellant was not regarded as a relevant consideration. The internal sewers were, essentially, part “of the equipment of the mine”³⁶⁶ and expenditure thereon, therefore, constituted payments towards developing the “income-producing machine.” The fact that the system was to become the property of the appellant was decisive as to the nature of the expenditure in

³⁶³ *New State Areas v CIR* 170.

³⁶⁴ De Koker and Williams *Silke on South African Income Tax* para 7.9.

³⁶⁵ Williams *Income Tax in South Africa Cases and Materials* 390 and D Meyerowitz *Meyerowitz on Income Tax* (2006) para 11.48.

³⁶⁶ *New State Areas v CIR* 170.

question. The external sewage system was held however to be on “a different footing.”³⁶⁷ Expenditure, in this regard, was held to be of a revenue nature. The instalments were held to be service payments to the municipality and, thus, revenue in nature. Once again the issue of ownership – or lack thereof in this case – proved decisive. The following statement by Watermeyer with respect to the external sewers is conclusive:

They do not form any part of the mine, they were not constructed for the improvement of the mining operations and they never became the property of the appellant. Consequently the appellant acquired no asset or right of any kind by paying the instalments which became due to the Town Council ...³⁶⁸

A further contention was raised by counsel for the Commissioner to the effect that even though such expenditure was revenue in nature, it was nevertheless not incurred in the production of income.³⁶⁹ Watermeyer was clearly not impressed with this submission and disposed succinctly of such in the following manner:

Seeing that the appellant cannot carry on its business without having sanitary conveniences, and that the sewage from them must be disposed of, and seeing that the appellant is compelled by law to allow the Town Council to dispose of his sewage and to pay the charges laid down by the tariff therefor (sic), it seems that the payment of the two basic charges is necessarily incidental to the earning of the appellant’s income and consequently, according to the principles accepted by this Court in the case of *Joffe & Co v Commissioner for Inland Revenue* (1946, A.D. 47) it was expenditure actually incurred in the production of income.³⁷⁰

It is interesting to note that in disposing of the Commissioner’s alternate contention Watermeyer made reference to another of his famous judgments discussed above. It can, therefore, be said that with reference to both his *PE Electric* and *Joffe* judgments, Watermeyer established yet another principle that would stand the test of time. These three judgments, essentially, form the basis for the interpretation of section 11(a). Each separate phrase in section 11(a) has, in essence, been conclusively interpreted by Watermeyer. ‘Expenditure and losses’ which are ‘actually incurred in the production of

³⁶⁷ *New State Areas v CIR* 171.

³⁶⁸ *New State Areas v CIR* 171.

³⁶⁹ *New State Areas v CIR* 173.

³⁷⁰ *New State Areas v CIR* 173.

income' are deductible provided such expenditure and losses 'are not of a capital nature.' The *Joffe* decision interpreted the first phrase, the *PE Electric* decision the second and the final one by *New State Areas*.

4.4.1 Application of Watermeyer's *New State Areas dicta*

It must be noted at the outset of this section that there have been numerous decisions that have referred to Watermeyer's *New State Areas* judgment. The cases discussed or referred to below represent merely a selection of these decisions aimed at illustrating the impact and wide acceptance of *New State Areas*. The first case that will be discussed is that of *SIR v Cadac Engineering*.³⁷¹ The respondent held the patent for a particular cooking appliance that was proving to be a success in South Africa. It should be noted that the patent was acquired from two brothers who were, in turn, the sole shareholders of the respondent. The respondent taxpayer continued to be the sole South African manufacturer of the particular cooking appliance until a competitor entered the market in late 1960. The brothers considered the competitor's appliance to be an infringement on their registered design. An interdict restraining the competitor was unsuccessfully applied for. This led to the incurring of legal expenses which the respondent taxpayer sought to deduct. The Commissioner declined to permit these deductions on the grounds that they were capital in nature. The Special Court found, however, that the expenditure was:

incidental to the performance of income-producing operations; it was the process of exploiting the taxpayer's rights to the fullest possible extent and it was not concerned with the creation, expansion, or preservation of the profit-yielding subject.³⁷²

The only issue on appeal was whether or not the expenditure in question constituted expenditure of a capital nature. There was substantial argument related to whether the issue at hand was a question of law or a question of fact. At the time this case was heard only questions of law could be reversed on appeal. Questions of fact could only be

³⁷¹ 27 SATC 61.

³⁷² *SIR v Cadac Engineering* 68.

reversed on appeal if it was found that the conclusion in the court *a quo* could not, reasonably, have been made.³⁷³ In other words if it was held that the issue of whether the expenditure was of a capital or revenue nature was a question of fact the Commissioner would have a more difficult *onus* to discharge. This is, however, not relevant for current purposes and, in any event, this rule has since changed – both questions of fact and questions of law are equally capable of appeal. It is interesting to note that Ogilvie Thompson JA, during argument directed towards whether the issue was one of fact or law, referred to the *New State Areas* decision as laying down a “test.”³⁷⁴ This is, quite clearly, implicit recognition by the learned judge of the correctness of Watermeyer’s statement of the law. The fact that it was referred to as a ‘test’ appears to highlight the fact that it was an inarguable principle. A ‘test’ seems to be something more than mere authority.

After concluding that the issue was a question of law Ogilvie Thompson JA went on to state that “expenditure ‘of a capital nature’ eludes precise and comprehensive definition.”³⁷⁵ The learned judge went on to state that:

Watermeyer C.J.’s well known, and often cited, summary of the authorities in *New State Areas, Ltd. v Commissioner of Inland Revenue*, 1946 A.D. 610 at 627, remains, in my opinion, the most useful general guide in determining what is almost invariably a somewhat evenly balanced and difficult problem.³⁷⁶

He then went on to repeat Watermeyer’s famous passage quoted above with respect to the difference between capital and revenue expenditure. The judgment under consideration was delivered in 1965 by which time Watermeyer’s *dicta* was already considered a test that could be applied with respect to determining the nature of an expense. Later in the judgment the learned Ogilvie Thompson JA, once again, referred to the *New State Areas* decision when he stated with reference to the expenditure in question that such costs could not be viewed as “incidental to the performance of (the taxpayer’s) income-

³⁷³ *SIR v Cadac Engineering* 69.

³⁷⁴ *SIR v Cadac Engineering* 72.

³⁷⁵ *SIR v Cadac Engineering* 72.

³⁷⁶ *SIR v Cadac Engineering* 74.

producing operations.”³⁷⁷ Ogilvie Thompson JA was unable to accept that a sufficient link had been created between the expenditure in question and the income-earning operations or activities and concluded, therefore, that the expenditure in question was of a capital nature. The decision was based more on the fact that the expenditure could not be regarded as revenue expenditure as opposed to the fact that such expenditure was certainly capital in nature. Expenditure must be one or the other. There is no “halfway house” between them.³⁷⁸

The next case to be discussed, which occurred four years previous to *Cadac Engineering*, was heard in the Rhodesian Federal Supreme Court on appeal from the High Court of Northern Rhodesia. The respondent in the case of *Commissioner of Taxes v Rhodesia Congo Border Timber*³⁷⁹ was granted a concession by the Rhodesian government to fell timber in a particular area. No rights were, however, vested in respondent with respect to the land after the area had been cleared. In order to access these areas the respondent constructed temporary access roads in order to remove the felled timber. These roads were abandoned and allowed to grow over once a particular area was clear.³⁸⁰ The respondent deducted the expenditure incurred in constructing the roads from its income. The Commissioner disallowed the deduction to which the respondent taxpayer objected. In finding in favour of the taxpayer all three sitting judges referred to the ‘test’ laid down by Watermeyer in the *New State Areas* decision. Although a copy of the High Court judgment is not available, it appears that the court *a quo* placed considerable reliance on the judgment of Watermeyer³⁸¹ which was, ultimately, confirmed on appeal. By 1965, therefore, the highest court in South Africa as well as the highest court in Rhodesia had sanctioned and accepted the *New State Areas* decision as a binding principle with respect to the determination of whether an expense is capital or revenue in nature. The judgment delivered by Williamson JA in the case of *SIR v John Cullum Construction*³⁸² subsequent to *Cadac Engineering*, but also in 1965, gave further credence to Watermeyer’s *dicta* by

³⁷⁷ *SIR v Cadac Engineering* 76.

³⁷⁸ *Pyott v CIR* 1945 AD 128 at 135.

³⁷⁹ 24 SATC 602.

³⁸⁰ *Commissioner of Taxes v Rhodesia Congo Border Timber* 604-605.

³⁸¹ *Commissioner of Taxes v Rhodesia Congo Border Timber* 607.

³⁸² 27 SATC 155.

labeling it as a “well recognized and frequently quoted test applicable” to the determination of whether a particular expense is capital or revenue in nature.

The appellant taxpayer in the 1973 case of *Palabora Mining v SIR*³⁸³ was involved in the establishment of a copper mine. A crucial factor in the establishment of the copper mine had been the availability of water. To this end a Water Board had been formed in the area. The Water Board experienced various delays which meant that the proposed barrage would, possibly, not be ready in time for the summer rainfall of 1965 – something the appellant considered vital for its 1966 business operations. The appellant, with this in mind, offered its services to the Water Board and undertook the construction of the barrage itself. The appellant utilised contractors and paid special fees to get the work done as quickly as possible. The overall effect of the arrangement was that the appellant avoided a delay of some eight months. The appellant, however, spent more than the Water Board had paid it for the undertaking. The appellant, despite this extra expenditure, received no proprietary rights in the barrage. The amount expended over and above the fees received from the Water Board amounted to approximately R1.8 million. The Commissioner declined to permit this as a deduction against the appellant’s income.³⁸⁴ Ogilvie Thompson CJ made it clear before discussing the applicable legal principles that the only issue on appeal was whether or not the amount in question constituted expenditure of a capital or revenue nature.

The learned judge proceeded to note that the creation of a right or asset, or lack thereof more importantly, was not, necessarily, decisive as to the nature of the expense. It was quite obvious on the facts of the matter that no new asset or right had been created by the appellant. It was merely “accelerating the acquisition of an adequate water supply”³⁸⁵ in order to take advantage of and earn income in the following year. Ogilvie Thompson CJ, with this in mind, did not consider the ‘enduring benefit’ test – which the Secretary had placed reliance on – to be of any assistance.³⁸⁶ The learned judge after dismissing the

³⁸³ 35 SATC 159.

³⁸⁴ *Palabora Mining v SIR* 167-170.

³⁸⁵ *Palabora Mining v SIR* 173-174.

³⁸⁶ *Palabora Mining v SIR* 174.

application of this test turned his attention to the case of *New State Areas*. It will be remembered that the same judge in the *Cadac Engineering* case referred to Watermeyer's judgment in *New State Areas* as a "most useful guide" in determining the revenue or capital nature of an expense. Ogilvie Thompson CJ, once again with reference to *New State Areas* stated that:

I turn now to consider the facts in light of the well-known and often cited statement by Watermeyer CJ in the *New State Areas Ltd* case at 627. In the *Cadac Engineering* case at 521-522 I ventured to express the opinion that that statement remains the most useful general guide in determining what is almost invariably a somewhat evenly balanced and difficult problem. I have not since had any reason to alter that opinion
...³⁸⁷

By 'that statement' Ogilvie Thompson CJ was clearly referring to Watermeyer's famous passage quoted above on page 95. Not only did Ogilvie Thompson CJ not change his mind, he found it necessary, "for greater clarity," to refer also to the following passage from Watermeyer's *New State Areas* judgment:

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 adding to the income-earning plant or machinery.³⁸⁸

The judge, after considering various cases, submitted by the appellant as authority, held that precedents are seldom useful in cases such as the one under consideration due to the unique nature of the facts. In other words each case had to be decided according to its own peculiar facts.³⁸⁹ Ogilvie Thompson CJ went on to state with reference to the actual facts of the matter that:

As was pointed out by Watermeyer CJ at 627 of the *New State Areas* case, and has frequently been reiterated in subsequent decisions of this court, in inquiries of the present kind, the purpose of the expenditure is an important factor.³⁹⁰

³⁸⁷ *Palabora Mining v SIR* 174.

³⁸⁸ *Palabora Mining v SIR* 174, *New State Areas v CIR* 164.

³⁸⁹ *Palabora Mining v SIR* 175.

³⁹⁰ *Palabora Mining v SIR* 175.

Ogilvie Thompson CJ concluded that the purpose of the expenditure was to accelerate the availability of an adequate supply of water and, thus, ensure the earning of profits in the subsequent year. The appellant received no proprietary rights and the barrage would have been constructed, in any event, some eight months later. The expenditure, in other words, did not create an enduring benefit nor did it add to the structure of appellant's mine and was, therefore, revenue in nature. It is interesting to note that the judgment delivered by Trengrove J in the case of *ITC 1267*³⁹¹ referred to the *New State Areas* case in light of both the *Cadac Engineering* and *Palabora Mining* decisions. The following was stated in this regard:

However, we have been referred in this regard to the well-known oft-cited summary of the authorities by Watermeyer CJ in *New State Areas Ltd v CIR* 14 SATC 155 at 170, which has on more than one occasion been described as '... the most useful general guide in determining what is almost invariably a somewhat evenly balanced and difficult problem.'³⁹²

If it was not already the case fifteen year previous, Watermeyer's *New State Areas* principle was utterly indisputable by 1977. Reference to two more recent cases will conclude this section.

The more recent case of *CIR v Manganese Metal*³⁹³ was heard in 1995 in the Transvaal Provincial Division. The facts are unimportant for the purposes of the present discussion. In an extensive and comprehensive judgment delivered by Wunsh J where a multitude of authority was referred to, the court came to the conclusion that expenditure on a waste disposal site constituted capital expenditure. In other words the taxpayer received a right from the local council to dispose of its waste at this particular site. Such a disposal facility was critical to the income-earning structure or machine of the taxpayer and was, therefore, held to be expenditure of a capital nature.³⁹⁴ After quoting various judgments – both domestic and foreign – it is interesting to note that the most extensive quotation was

³⁹¹ 39 SATC 146.

³⁹² *ITC 1267* 148.

³⁹³ 58 SATC 1.

³⁹⁴ *CIR v Manganese Metal* 20.

extracted from Watermeyer's *New State Areas* judgment. The case of *Palabora Mining* was also quoted with approval. Ogilvie Thompson CJ's comments with respect to Watermeyer's famous passage will be remembered. It is also notable that Wunsh J before ruling in favour of the Commissioner referred, once again, to the *New State Areas* case where he stated that:

... bearing in mind the *dictum* of Watermeyer CJ in the *New State Areas* case that in determining the true nature of a transaction, in order to decide whether expenditure is of a capital nature, the purpose of the expenditure is the important factor.³⁹⁵

The last case that will be discussed in this section is the very recent case of *BP Southern Africa v C:SARS*.³⁹⁶ In a particularly straightforward and understandable judgment, Ponnan JA held in favour of the taxpayer. The appellant's parent company based in the UK entered into a deal with the appellant taxpayer whereby it agreed to allow the taxpayer to use its trademark, schemes and designs for a stipulated royalty fee.³⁹⁷ The agreement was initially entered into for a period of two years whereafter it would be automatically renewed for another twelve months unless terminated by either party giving six months notice.³⁹⁸ The respondent contended that the taxpayer was to receive a far greater benefit than was stipulated in the agreement. In other words the respondent's contention was that the agreement would continue to exist for a period far longer than the terms of the agreement suggested. Ponnan JA stated in this regard that the respondent had not attempted to argue that a simulated transaction had been engineered and with reference, interestingly, to Watermeyer's *Randles Brothers* decision, held that the court was, therefore, not entitled to speculate beyond the terms of the agreement.³⁹⁹ In dealing with the applicable legal principles Ponnan JA paraphrased Watermeyer's *New State Areas dictum* in the following manner:

The purpose of expenditure is important and often decisive in assessing whether it is of a capital or revenue nature. Expenditure incurred for the purposes of acquiring a capital asset of the business is capital

³⁹⁵ *CIR v Manganese Metal* 20.

³⁹⁶ [2007] SCA 7 (RSA).

³⁹⁷ *BP Southern Africa v C:SARS* para 3.

³⁹⁸ *BP Southern Africa v C:SARS* para 9.

³⁹⁹ *BP Southern Africa v C:SARS* para 11.

expenditure whereas expenditure which is part of the cost incidental to the performance of the income-producing operations as distinct from the equipment of the income-producing machinery is revenue in nature (*New State Areas v Commissioner for Inland Revenue* 1946 AD 610 at 627) . . . The conclusion to be drawn from all the cases seems to be that the true nature of each transaction must be examined in order to determine whether the expenditure in question is capital or revenue expenditure (*New State Areas v Commissioner for Inland Revenue* 1946 AD 610 at 627).⁴⁰⁰

The similarity of this passage to Watermeyer's actual words quoted previously is unmistakable. Ponnán J after a consideration of both the facts as well as the applicable legal principles, compared the royalty payments to rental payments. The royalty payments were akin to rental payments due to the fact that the taxpayer never acquired ownership in the trademark or design. Payments were made for the use thereof. The taxpayer was, essentially, renting the trademark and design from its parent company for an agreed period of time. Ponnán J stated in this regard that:

The anticipated and actual recurrent nature of the disputed payments is a strong indicator that they related to revenue rather than capital. The recurrent cost of procuring the use of something which belongs to another is usually recognised as being of a revenue nature. The most obvious example is the recurrent rent paid by a taxpayer for the use of premises from which he/she trades.⁴⁰¹

Ponnán J ruled, as stated above, with the *New State Areas* decision in mind, against the Commissioner. The above discussion is overwhelming evidence of the wide acceptance and usage of Watermeyer's *New State Areas dictum*. It is quite clearly held in high regard by our courts and academics alike. The fact that it is the *locus classicus* on the difference between capital and revenue expenditure is unquestionable.

4.4.2 Conclusion and summary of Watermeyer's *New State Areas* contributions

The impact of this decision on South African tax law was, and continues, to be profound. The cases referred to above constitute only a small collection of the numerous decisions of various courts where reference to the *New State Areas* decision has been made. It is

⁴⁰⁰ *BP Southern Africa v C:SARS* para 11.

⁴⁰¹ *BP Southern Africa v C:SARS* para 14.

interesting to note that Wright opined that this particular judgment delivered by Watermeyer ensured his “place in the pantheon of South African tax law.”⁴⁰² It is somewhat gratifying that in the last of Watermeyer’s famous judgments he, essentially, rounded off his interpretation of section 11(a). The *Joffe* decision contributed towards the interpretation of ‘expenditure of losses.’ The *PE Electric* judgment dealt with expenditure ‘actually incurred in the production of income’ and, finally, the *New State Areas* decision dealt with the difference between capital and revenue expenditure. Many of the features of his previous judgments were once again apparent in *New State Areas*. His exceptional use of examples in order to explain complex distinctions or concepts was, once again, evident. His lecture-like mode of argument was referred to in the analysis of the judgment itself. Once again his relentless attitude towards faultless research was evident. This was highlighted by his reference to several judgments – both domestic and foreign. It is also noticeable that subsequent judgments tended to look not only to the actual decision made by Watermeyer but also to the authority he referred to in coming to that decision.⁴⁰³ It must, however, be conceded that there is no discernible method of statutory interpretation contained in the judgment. Whilst the decision itself was a most understandable and well-structured argument, it cannot be submitted with sufficient certainty what method of statutory interpretation was applied. The magnitude of the practical contribution that Watermeyer delivered in this judgment outweighs, it is submitted, the lack of a traceable method of statutory interpretation. Just as the *Lever Bro’s* decision is invoked whenever the issue of source arises, the *New State Areas* decision is usually invoked in the context of determining whether an expense is of a capital or a revenue nature. The above section also highlights the diversity of applicability of Watermeyer’s *New State Areas* principle. Evidence of this lies in the fact that the *dictum* was invoked to deal with situations ranging from the establishment of a waste disposal facility to the payment of royalty fees for the use of a trademark.

⁴⁰² Wright 2009 *Tax Planning* 96.

⁴⁰³ For example: *Commissioner of Taxes v Rhodesia Congo Border Timber* 24 SATC 602 and *SIR v John Cullum Construction* 27 SATC 155.

The final case that will be discussed is that of *CIR v King*.⁴⁰⁴ Whilst not considered one of his major contributions or landmark judgments it is, nevertheless, an interesting judgment that complements, in the context of this thesis, the *Randles Brothers* decision. The reason it is complementary is that while *Randles Brothers* dealt with common law principles of tax avoidance the *King* case dealt with anti-avoidance legislation.

4.5 Watermeyer's King decision

It must first be noted that general anti-avoidance rules are contained in enacted legislation and are designed to stop taxpayers avoiding liability for tax by some or other transaction or scheme. The facts of the following case are not particularly important for the purposes of the present discussion but are, nevertheless, important for the sake of completeness and consistency of analysis. In what has been labelled the “most important decision of 1947”⁴⁰⁵ respondent taxpayer in the case of *CIR v King* sold shares in a private company to his child. The purchaser (child) paid for these shares by way of a loan advanced by the organisation of which the seller was a partner. Provision for interest was included in the agreement. The agreement further stipulated that any declared dividends, although vesting in the purchaser, would be used to decrease the purchaser's indebtedness to the organisation. The purchaser was, however, entitled to draw a certain amount on an annual basis. The purchaser was also to pledge its shares until such time as the loan was fully repaid. This allowed the organisation to use the pledged shares as security for various loans it had received. The result of the above transaction was that the respondent divested himself of the ownership of the relevant shares and received a purchase price of approximately £23 500. This purchase price was reflected by a credit entry in the books of the organisation.⁴⁰⁶ Section 90 of the Income Tax Act of 1941 contained general anti-avoidance rules which the Commissioner, with the above transaction in mind, invoked against the taxpayer. Section 90 read as follows:

⁴⁰⁴ 14 SATC 184.

⁴⁰⁵ BA Ettlinger “Taxation: Case Law” 1947 *Annual Survey* 128 at 128.

⁴⁰⁶ *CIR v King* 186-187.

Whenever the Commissioner is satisfied that any transaction or operation has been entered into or carried out for the *purpose of avoiding liability for the payment of any tax imposed by this Act, or reducing the amount of any such tax*, any liability for any such tax, and the amount thereof, may be determined, and the payment of the tax chargeable may be required and enforced, as if the transaction or operation had not been entered into or carried out.

Provided that any decision of the Commissioner under this section shall be subject to objection and appeal, and in any proceedings relating thereto, whenever it is proved that the transaction or operation in question would result in the avoidance of liability for the payment of any such tax, or in the reduction of the amount thereof, it shall be presumed, unless the contrary is proved, that the transaction or operation was entered into or carried out for the purpose of avoiding such liability or of reducing such amount (own emphasis).⁴⁰⁷

After stating the above provision Watermeyer embarked on a thorough analysis thereof. Watermeyer criticised the italicised line above by stating, essentially, that a literal approach would lead to absurdity. With this in mind it was held that section 90 and the italicised part above referred to ‘anticipated’ liabilities for taxation.⁴⁰⁸ In other words it is “impossible”⁴⁰⁹ to avoid past liabilities for tax which the provision – on a literal reading - may have included. Such liability has come and gone. It cannot be avoided. A further absurdity that might occur if a literal approach was adopted to the above provision was neatly illustrated by the following example:

A man can for instance simply close down his business or resign from his employment but it is absurd to suppose that the Legislature intended to impose a tax upon a man who enters into such a transaction or operation as if he had an income, which in fact he has not got, merely because his purpose was to avoid exposing himself to liability for taxation by having an income.⁴¹⁰

Once again Watermeyer’s use of an illustrative example is welcomed. What is quite a technically challenging judgment is simplified by the use of such examples. Watermeyer then, in order to make his point unmistakably clear, went on to add a myriad of further illustrative examples:

⁴⁰⁷ Act 31 of 1941, *CIR v King* 189.

⁴⁰⁸ *CIR v King* 190.

⁴⁰⁹ *CIR v King* 190.

⁴¹⁰ *CIR v King* 190-191.

For example a man can sell his investments which produce income subject to tax and in their place make no investments at all, or he can spend the proceeds in buying a house to live in, or in buying shares which produce no income but may increase in value, or he may invest the proceeds outside of the Union, or make investments which produce income not subject to normal tax in his hand... He can also sell shares in private companies, the holding of which may subject him to heavy taxation in his hands although he does not receive the income which is taxed, or he can sell shares in companies which pay high dividends and invest in securities which return him a lower but safer and more certain income. He might even have conceived such a dislike for the taxation under the Act that he sells all his investments and lives on his capital or gives it away to the poor in order to not have to pay such taxation... He can carry out such operations for the avowed purpose of reducing the amount of tax he has to pay, yet it cannot be imagined that Parliament intended by the provisions of sec 90 to do such an absurd thing as to levy a tax upon persons who carry out such operations as if they had not carried them out.⁴¹¹

De Koker and Williams, with respect to section 80A, – the latest general anti-avoidance provision – state that the above words uttered by Watermeyer, “although relating to s 90 of the Income Tax Act 31 of 1941, remain valid.”⁴¹² It should be noted that Watermeyer, in the last sentence of the above passage, referred to the intention of Parliament. This is obviously the equivalent of the intention of the Legislature. It was stated in chapter two that when the intention of the legislature is used as a legal fiction it becomes, somewhat similar, to a purposive-oriented approach. It was also submitted above that Watermeyer used the intention of the legislature as a legal fiction and, as such, it was suggested above that he employed – by and large, though not consistently – a purposive-oriented approach to statutory interpretation. The same submission is applicable with respect to the current case discussion. A literal approach to section 90 would have lead to absurdity and, as such, Watermeyer invoked the intention of the legislature as a fiction in order to interpret section 90 in accordance with the purpose behind it. Counsel for the Commissioner recognised the absurdity that may occur if section 90 was employed literally but attempted to circumvent it by arguing that the Commissioner was given a clear discretion as to whether to invoke section 90 or not.⁴¹³ This was argued on the basis that the word ‘may’ was included in the provision. The reader is referred to section 90 quoted above in this regard. Once again Watermeyer exposed his non-literalist nature and held that

⁴¹¹ *CIR v King* 191-192.

⁴¹² De Koker and Williams *Silke on South African Income Tax* para 19.5.

⁴¹³ *CIR v King* 192.

despite the use of the word ‘may,’ the Commissioner was, in actual fact, compelled to invoke section 90 when the described set of circumstances, as laid out by the provision, arose. The following passage by Watermeyer is instructive in this regard:

It could surely not have been the intention of the Legislature that the Commissioner should be given a discretion, when he has been satisfied that the transaction falls within sec 90, in one case to say “I will use my powers under the section” and yet in respect of another possible identical transaction he should be able to say “I will not use these powers.”⁴¹⁴

The intention of the Legislature is, once again, referred to. Literally speaking the Commissioner has clearly been given discretion as to the invocation of the provision. Watermeyer, however, went behind the literal meaning in order to determine the purpose, rather than literal meaning, of the provision in question. After outlining the above issues that may arise with respect to the employment of a literal approach, Watermeyer went on to state that it was:

...necessary therefore to search for some other meaning of sec 90 which will not lead to such unsatisfactory results and, as I shall show, such a meaning can be found.⁴¹⁵

This is further evidence of his implicit rejection of the literal approach with respect to section 90. Watermeyer went on to question what “type of transaction or operation was the legislature intending to nullify for taxation purposes.” The question that was asked was, essentially, what the purpose behind the enactment was. The overall conclusion with respect to this question was that the provision was not directed:

...against the person who so orders his affairs that he has no income which would expose him to liability for income tax, but against the person who so orders his affairs that he escapes from liability for taxation which he ought to pay upon income which is in reality his.⁴¹⁶

⁴¹⁴ *CIR v King* 192.

⁴¹⁵ *CIR v King* 192.

⁴¹⁶ Ettliger 1947 *Annual Survey* 129.

The conclusion was, therefore, that transactions honestly entered into cannot come under attack from section 90. When, however, a transaction does come within the ambit of section 90, the Commissioner must apply the provision. In other words no discretion, as was discussed above, is permissible. Furthermore, as was noted above, the provision refers only to ‘anticipated’ liabilities for taxation. The most important part of Watermeyer’s decision in terms of modern day relevance and durability came towards the end of his judgment when he briefly considered the meaning to be attributed to the word ‘purpose’ as used in section 90 and quoted in italics above. Whilst it is conceded that the Provincial Division initially held that, by purpose, it was meant ‘dominant’ purpose, the Appellate Division had to adopt it before nationally binding precedent was created. Watermeyer stated, in this regard, that:

The Cape Provincial Division held that the words “the purpose” which appear in sec 90 meant not merely an incidental purpose but the dominant purpose. I agree with that conclusion ...⁴¹⁷

The relevance of this adoption of the Cape Division’s interpretation of the law will be briefly discussed in the subsequent section. Reference to Watermeyer’s lecture-like manner of delivering judgments has been referred to in previous sections. In explaining the fundamental operation of our taxation system Watermeyer stated the following:

The starting point is “gross income”, i.e. the total amount received by or accrued to a person from a source within the Union, less certain receipts of a capital nature. From “gross income” receipts and accruals which are exempt from normal tax are deducted and the result is called “income”. From “income” the deductions which are permissible in terms of the Act, consisting mainly of the expenditure incurred in earning income are subtracted; the result is called “taxable income.” From “taxable income” abatements permissible in terms of the Act are deducted and the result is called “taxable amount”.⁴¹⁸

Where Watermeyer made reference to permissible deductions in terms of the Act, it must be remembered that he is, essentially, responsible for laying down the applicable principles when determining whether an expense is deductible. The lecture-like nature of this explanation is clear. There is no possible confusion or ambiguity and the

⁴¹⁷ *CIR v King* 198.

⁴¹⁸ *CIR v King* 194.

comprehensibility or understandability of it is beyond question. The eventual outcome of this case is the least important part of it. Watermeyer's style of judgment and method of interpretation are far more significant factors. Watermeyer held in favour of the taxpayer due to the fact that it was not possible to regard the expectation of a dividend as income. It was, essentially, an alienation of capital – not income. The following was stated in this regard:

When a dividend on a share is declared, payable on a certain date, an act is done which determines the amount of income derived from such share and the person to whom it will accrue; but until that occurs it is impossible to say that any definite amount is the income of any one of the persons who may have owned the share during the course of the year of assessment. There may be several persons who have owned the share consecutively throughout the accounting period and they may have owned it for different periods... The expectation of a dividend attached to the share is an attribute of the share which may enhance its temporary value but it cannot for that reason be regarded as income.⁴¹⁹

The following section will concentrate on Watermeyer's contribution to anti-avoidance legislation in light of the *King* decision.

4.5.1 The impact of *King* on section 80A

Section 90 quoted above was replaced by section 103(1) in 1959.⁴²⁰ Section 103(1) was not radically different from section 90. It was amended twice in 1978 and 1996. These amendments did not, however, significantly alter its application. A somewhat revised and more comprehensive approach to tax avoidance was adopted with the enactment of sections 80A to 80L. These sections became effective from November 2006.⁴²¹ Section 80A reads as follows:

An avoidance arrangement is an impermissible avoidance arrangement if its sole or main purpose was to obtain a tax benefit and –

(a) in the context of business –

⁴¹⁹ *CIR v King* 196-197.

⁴²⁰ De Koker and R Williams *Silke on South African Income Tax* para 19.2

⁴²¹ De Koker and R Williams *Silke on South African Income Tax* para 19.2

- (i) it was entered into or carried out by means or in a manner which would not normally be employed for *bona fide* business purposes, other than obtaining a tax benefit; or
 - (ii) it lacks commercial substance, in whole or in part, taking into account the provisions of section 80C;
- (b) in a context other than business, it was entered into or carried out by means or in a manner which would not normally be employed for a *bona fide* purpose, other than obtaining a tax benefit; or
- (c) in any context –
- (i) it has created rights or obligations that would not normally be created between persons dealing at arm's length; or
 - (ii) it would result directly or indirectly in the misuse or abuse of the provisions of this Act (including the provisions of this part).⁴²²

From section 80B onwards an elaboration of this provision is provided, as well as a stipulation of various procedural requirements. It is not necessary for current purposes to quote and discuss them. Section 80A, like section 103(1), requires the satisfaction of four elements in order for the Commissioner to be successful in an action against a taxpayer.⁴²³ The first is that a transaction, operation, scheme or arrangement must have been entered into by the taxpayer. This is usually a formality due to the broad terms in which this requirement is couched. The second requirement is that a tax benefit must have arisen. A 'tax benefit' includes "any avoidance, postponement or reduction of any liability for tax."⁴²⁴ Once the Commissioner has proven the presence of a tax benefit a presumption comes into operation to the effect that the obtainment of such a benefit was the sole or main purpose of the arrangement (section 80G). The third requirement is known as the 'abnormality' requirement. Sub-sections 80A(a) to (c) stipulate the various types of abnormality that may be present. The fourth and final requirement is that the obtainment of a tax benefit must be the sole or main purpose of the transaction or arrangement.⁴²⁵ The presumption of purpose, created by section 80G, must be remembered in this regard.

⁴²² Act 58 of 1962.

⁴²³ Williams *Income Tax in South Africa Cases and Materials* 568.

⁴²⁴ Act 58 of 1962.

⁴²⁵ Williams *Income Tax in South Africa Cases and Materials* 568, *SIR v Geustyn, Forsyth and Joubert* 33 SATC 113 at 117.

The reader is referred to the first line of section 80A where reference to the fact that in order for a transaction to be attacked in terms of section 80A a tax benefit must either be the sole or main purpose of such transaction. At the time of the *King* decision section 90 stipulated only the word ‘purpose.’ It was unclear, in other words, whether such purpose was intended to be merely incidental or dominant. Watermeyer adopted the approach of the Cape Provincial Division in his decision to the extent that, by purpose, the Legislature intended to convey the idea of dominant purpose. This interpretation was, subsequently, given legislative recognition in both sections 103(1) and, thereafter, section 80A. With respect to what constitutes a ‘tax benefit’ De Koker and Williams, as stated above, submit that the words of Watermeyer in the *King* decision “remain valid.”⁴²⁶ Watermeyer’s description – using a variety of examples quoted at page 108 – of what does not constitute a ‘tax benefit’ in terms of section 80A was referred to in this regard and is, therefore, still applicable. The learned authors, thereafter, refer to the fact that only ‘anticipated’ liabilities for tax are considered in terms of section 80A. Watermeyer’s *King* decision is referred to as the primary authority for this submission.⁴²⁷

De Koker and Williams, once again, make reference to the *King* decision when discussing “arrangements in a context other than business.” The reader is referred to section 80A(b). De Koker and Williams state, with respect to the normality or abnormality requirement, that:

...a taxpayer may carry out any transaction for the *avowed* purpose of avoiding or reducing the amount of tax he has to pay (own emphasis).⁴²⁸

This passage bears a striking resemblance to the third last line of the passage quoted at page 108. It is, quite clearly, taken directly from the Watermeyer judgment. De Koker and Williams state, with reference to the same passage, that any of the instances or examples outlined by Watermeyer would be compliant with the normality requirement. In other words section 80A, with respect to any of these examples, would not be capable

⁴²⁶ De Koker and Williams *Silke on South African Income Tax* para 19.5.

⁴²⁷ De Koker and Williams *Silke on South African Income Tax* para 19.5.

⁴²⁸ De Koker and Williams *Silke on South African Income Tax* para 19.7.

of invocation due to the fact that no abnormality is present. A transaction is permissible so long as it is normal even if its only purpose is the avoidance of tax.

It is quite remarkable that a judgment based on a provision replaced in 1959 still has the degree of influence that *King* has been shown to have. Watermeyer's *dicta* is, therefore, not only relevant to common law principles of tax avoidance with respect to *Randles Brothers*, but has also, in terms of *King*, had a significant impact on the legislative side of tax avoidance.

4.5.2 Conclusion and summary of Watermeyer's *King* contributions

This judgment, although not readily recognised as one of Watermeyer's greatest achievements, is the epitome of a decision that has stood the test of time. Not only has it withstood the test of time, but it has withstood the test of several, quite significant, legislative changes. This is, perhaps, a more difficult test to withstand. The usual features associated with his judgments discussed above are, inevitably, apparent. His use of examples with respect to what cannot constitute a liability for taxation 'remains valid.' Anti-avoidance legislation is difficult to comprehend and the examples given by Watermeyer provide the reader with a solid foundation as to what does not constitute an avoidance transaction or scheme. It was, on this note, that Watermeyer stated, essentially, that a literal approach to section 90 was unworkable. He was evidently, with reference to the intention of the legislature, attempting to apply a purposive-oriented approach in order to come to an acceptable interpretation of the provision. Evidence of this was referred to above. Although there has as yet been no reported case law on the interpretation of section 80A, it is suggested that when such a day comes, significant reference to Watermeyer's *King* judgment will, inevitably, in light of the above discussion, be made.

4.6 Conclusion

It was noted in the conclusion of the previous chapter that Watermeyer's contributions to South African tax law – whilst impressive – were not, quite, sufficient to warrant describing him as a “giant of the South African judiciary.” The highly influential nature of the four judgments analysed above has been emphasised through reference to case law and various tax publications. The magnitude of their impact has been demonstrated by numerous references by courts and academics, alike, to the analysed judgments. The application and interpretation of section 11(a), as was noted above, is entirely dominated by Watermeyer's interpretation thereof. Watermeyer's interpretation of the word ‘source’ as it appears in the definition of gross income is unquestioningly followed by courts and academics alike. The debate over the acceptability of apportionment of ‘source’ has its origins in an *obiter* statement delivered, also, in the *Lever Brothers* decision. The *King* decision, although decided in terms of a provision that was replaced in 1959 and then, again, in 2006, remains influential with respect to section 80A. Watermeyer's approach to statutory interpretation was, once again, not always discernible. Whilst it was suggested that clear evidence that a purposive-oriented approach was adopted in the *King* and *Lever Bro's* decisions, such evidence was lacking in the *Joffe* and *New State Areas* decisions. No conclusive submission, with respect to his approach to statutory interpretation, with the above four cases in mind, can, therefore, be made. It must be noted again, however, that the prevailing and accepted approach to statutory interpretation at the time these judgments were delivered was a literal one. This may, as was suggested in the conclusion of the previous chapter, be a reason for the lack of Watermeyer's overt rejection of literalism and embracement of purposivism. His excellent employment of analogy and examples was highlighted as creating a link between the technical exposition of the law and the practical application thereof. The use of examples together with his lecture-like approach to basic or fundamental concepts contributed, it is submitted, heavily towards the durability of the four decisions discussed above. The principles established in these cases are capable of application to a variety of original sets of facts. The fact that the established principles can be applied to varying sets of circumstances bears testament to their durability and diversity of application.

Watermeyer's contributions to South African tax law are remarkable. The fact that his interpretations dominate one of the most highly contested provisions in section 11(a) is extraordinary. His contributions in terms of the definition of gross income are also significant. Another major concern for tax legislators and authorities, alike, is the issue of tax avoidance. Watermeyer has made substantial contributions with respect to both the common law principles applicable to simulated or disguised transactions as well as the interpretation of legislative enactments aimed at combating tax avoidance. The definition of gross income, the application of section 11(a) and concerns about tax avoidance are some of the most significant aspects of our taxation system. Watermeyer's statements of the law with respect to all three areas remain respected and, more importantly, authoritative. His description as a 'giant of the South African judiciary', with all seven of the analysed judgments in mind, appears to have been quite convincingly earned. The following chapter will provide a summary of his achievements as well as suggestions for further research.

CHAPTER FIVE: CONCLUSION

The above discussion has highlighted the extent of Watermeyer's contributions to South African tax law. Not only have the principles enunciated in the above cases stood the test of time, they have served also to establish the basis from which many subsequent judgments have been premised and decided on. The style, manner and technique with which the above judgments were delivered has also been discussed and analysed as contributions in their own right. The method of statutory interpretation employed was also alluded to where sufficient evidence of a specific approach was found. A clearly purposive-oriented approach was identified in some judgments whilst such evidence was not as clear in other cases. As stated above, however, any evidence of a purposive approach at the time in which the above judgments were delivered must be viewed as a significant achievement in light of the prevailing attitude to statutory interpretation at that time. The different schools of thought with respect to statutory interpretation were introduced in Chapter Two in an attempt to show the reader how the subject of statutory interpretation was relevant to this thesis and to, furthermore, provide a basic understanding of the importance of the subject.

The first decision analysed was delivered in 1926 in the case of *Lategan v CIR*. The definition of gross income in section 1 of the Act was interpreted in terms of the meaning to be ascribed to the word 'amount'. The phrase 'accrued to' was also interpreted. It was held that 'amount' required a wide interpretation to accord with the intention of the legislature and was not limited to only cash amounts or monies received. Rights and other forms of non-money based income are, in terms of this judgment, assessable. The phrase 'accrued to or in favour of any person' was interpreted simply to mean 'to which he has become entitled.' The approach to statutory interpretation in this case was found to be purposive oriented in that Watermeyer relied on the intention of the legislature as a legal fiction. It was noted in chapter two that where legislative intention is used as a legal fiction, it becomes almost indistinguishable from a purely purposive approach. The reasoning and logic behind the interpretation of these terms has never been doubted and was convincingly confirmed in the *Peoples Stores* case. *Lategan* and the interpretations

that resulted from it are absolutely fundamental to our entire tax system. In other words a taxpayer's gross income needs to be established before other provisions can be properly applied.

The second case that received analysis was that of *Port Elizabeth Electric Tramway v CIR*. The interpretation of section 11(a) (as it is now known) was the central issue. The essential facts were that an employee of the taxpayer had been killed whilst on duty and the taxpayer was required to pay damages in terms of the Workmen's Compensation Act (now repealed). The question that needed to be addressed was whether the damages payments and associated legal expenses were permissible deductions considering whether the disbursements were incurred 'in the production of income.' The Court held that the damages payments themselves were incurred in the production of income but the associated legal expenses were not. This somewhat anomalous situation was rectified by the inclusion of section 11(c) some years later. This judgment's most celebrated achievement was the description given by Watermeyer of expenditure that would be considered deductible. The following was stated in this regard:

Here, in my opinion, all expenses attached to the performance of a business operation *bona fide* performed for the purpose of earning income are deductible whether such expenses are necessary for its performance or attached to it by chance or *bona fide* incurred for the more efficient performance of such operation provided they are so closely connected with it that they may be regarded as part of the cost of performing it.

This passage has been quoted on countless occasions by subsequent courts, academics and textbooks alike. It remains authoritative on the applicable law governing permissible deductions. This, it is submitted, is an extraordinary achievement given the fact this judgment was delivered in 1936. The above passage was, however, not the only offering this judgment had to South African tax jurisprudence. The difference in meaning between 'actually incurred' and 'necessarily incurred' was also canvassed and the interpretation of 'actually incurred' remains applicable law. Other less significant achievements were also referred to.

It was suggested that a purposive approach may have been applied given the fact that a more literal approach may have yielded fewer permissible deductions. Watermeyer's use of illustrative examples and lucid explanations contributed to the lecture-like nature of this judgment. The style with which he delivered this judgment, it was suggested, significantly contributed to the extensive use of this judgment as applicable authority for determining the nature of permissible deductions. The achievements in terms of this decision must also be considered in light of the fact that section 11(a) is probably the most contested provision in the Act.

The final judgment analysed in the third chapter was delivered in the lesser known case of *Commissioner of Customs and Excise v Randles Brothers and Hudson*. This judgment articulated and expounded upon the common law principles of tax avoidance. In an impeccably researched and considered decision Watermeyer explained what is meant by a disguised or simulated transaction. It is interesting to note that despite two dissenting judgments, this case was referred to authoritatively in the more recent case of *Ladysmith*. Whilst *Zandberg* is still considered the authority of what constitutes a simulated or disguised transaction, it is suggested that such authority is now read together with *Randles Brothers* as applied in *Ladysmith* as the overriding authority on the matter. The core issue in *Randles Brothers* appears to have been the correct interpretation of what constitutes 'intention'. The taxpayer was required to sell certain garments on to a registered manufacturer in order to claim an available rebate. It was alleged by the taxing authorities that there was no genuine sale in that there was no actual intention to transfer ownership due to the circumstances that existed. Watermeyer, in finding against the taxing authorities, stated that:

It was so much in their interest to have the intention of transferring ownership that it is difficult to believe that they did not have it.

In other words if they did not have the intention of entering into a genuine sale, it would have been disadvantageous as the taxpayer would not have received a rebate. Once again the exceptionally logical and understandable nature of Watermeyer's reasoning is apparent. So much so that Hefer J in the *Ladysmith* case only found it necessary to refer

to Watermeyer despite the presence of compelling dissenting judgments. It is submitted that Watermeyer's explanation of what constitutes a disguised or simulated transaction is particularly impressive given the fact that this principle, developed some seventy years ago, was applicable to a novel situation presented to the courts in the case of *Ladysmith*.

The first case analysed in Chapter Four was *Joffe v CIR*. This case was found, however, to be the least compelling of Watermeyer's so called landmark judgments. The reasoning behind the decision was somewhat confusing which has had the effect of creating academic confusion on the matter. The basic facts were that an employee of the taxpayer was killed when a concrete hood collapsed on him. The taxpayer was held to be negligent in a delictual claim and was ordered to pay damages to the dependants of the deceased. The taxpayer alleged that such damages were permissible deductions as they were incurred, in terms of section 11(a), 'in the production of income.' It was suggested above that based on Watermeyer's explanation as to the difference between 'actually incurred' and 'necessarily incurred' the taxpayer decided to argue the matter on the basis that such expenses were actually incurred by the specific taxpayer in the course of his business and, therefore, in the production of income. This suggestion was made in light of Watermeyer's example of the inefficient businessman. An inefficient businessman incurs more expenses than the efficient businessman but these expenses are still deductible. Negligence, by definition, is the product of inefficiency or carelessness. Watermeyer, however, found against the taxpayer due to the fact that the negligence that occurred was not a necessary concomitant of the taxpayer's trade. This finding was arrived at despite the fact that such negligence had occurred in the course of the taxpayer's trade and the taxpayer's argument had been premised on the way the individual taxpayer carried on his business. It was suggested that his reference in the *PE Electric* case to the fact that unlawful or negligent acts may not be deductible influenced his finding with respect to the taxpayer in *Joffe*. Despite a somewhat anomalous outcome this decision established the following useful interpretation of the difference between 'expenditure' and 'losses' as set out in section 11(a):

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.

It is interesting to note that although this distinction has been quoted by several subsequent courts and publications alike, Watermeyer went on to state that no real difference in meaning between the two exists. This decision is, therefore, in the strange situation where it is both authority for the difference in meaning and the lack of difference in meaning. Whilst it is conceded that this judgment was not Watermeyer's most compelling judgment, it is still of significance due to its long-lasting interpretation of the difference or lack of difference between 'expenditure' and 'losses.'

The second judgment analysed in Chapter Four was that of *CIR v Lever Brothers and Unilever*. This judgment was one of Watermeyer's most outstanding achievements from a practical point of view as well as from a stylistic point of view. It is absolutely indisputable that this judgment is the leading authority on the interpretation of the word 'source' as it appears in the definition of gross income. The facts are rather complex and need not be repeated here save to say that the source of particular income was under consideration. This judgment provided, possibly, the best example of Watermeyer's ability to clarify issues, explain complex or controversial concepts simply and to create a model of understanding in the reader's mind. This is stated with reference to his explanation of what constitutes a debt as well as his analogy between the renting of a property and the lending of money. These explanations provide excellent examples of his lecture-like manner of delivering judgments. Watermeyer, in demonstrating his exceptional attention to detail and research, referred to both local and foreign authority on the interpretation of the word 'source' as it appears in the definition of gross income. In considering and examining such authority Watermeyer stated, in a passage that has been quoted on countless occasions, that:

In this section it is used figuratively, and when so used in relation to the receipt of money one possible meaning is the originating cause of the receipt of the money, another possible meaning is the quarter from which it is received. A series of decisions of this Court and of the Judicial Committee of the Privy Council upon our Income Tax Acts and upon similar Acts elsewhere have dealt with the meaning of the word

“source” and the inference, which, I think, should be drawn from these decisions is that the source of receipts, received as income, is not the quarter from whence they come, but the originating cause of their being received as income and that this originating cause is the work which the taxpayer does to earn them, the *quid pro quo* which he gives in return for which he receives them. The work he does may be a business which he carries on, or an enterprise which he undertakes, or an activity in which he engages and it may take the form of personal exertion, mental or physical, or it may take the form of employment of capital either by using it to earn income or by letting its use to someone else. Often the work is a combination of these.

This passage remains unquestionably the correct pronouncement of the applicable law with respect to the interpretation of the word ‘source.’ This judgment also raised the issue of apportionment of source – a concept that remains unclear in our jurisprudence to date. It was stated with respect to apportionment of source that:

Such a state of affairs may lead to the conclusion that the whole receipt, *or part of it*, or none of it is taxable as income from a source within the Union, according to the particular circumstances of the case, but I am not aware of any decision which has laid down clearly what would be the governing consideration in such a case (own emphasis).

It appears, as noted above, that this *obiter* passage remains the most acceptable statement with respect to the possibility of apportioning source. This is quite remarkable given the fact that apportionment of source was not even argued. The style of interpretation adopted with respect to the meaning of ‘source’ appears to have been contextual-purpose oriented in that Watermeyer made express mention of the fact that ‘source’ was capable of several meanings. When bearing in mind his reference to ‘figurative language’ which is a synonym for non-literal, this possibility becomes all the more compelling. This decision, as stated above, was an impeccable illustration of Watermeyer’s ability to isolate a problem, explain it in a most comprehensible fashion and apply it to a factual situation in a logical and understandable fashion. It is submitted that it is this preciseness together with the practical applicability of the principle that has led this decision to withstand the test of time and remain the overriding and undisputed authority on the matter.

The penultimate decision analysed in the fourth chapter is, perhaps, Watermeyer's most widely known and quoted decision. The case of *New State Areas v CIR* depicts a masterful exposition of the difference between capital and revenue expenditure in terms of section 11(a). Whilst revenue expenditure constitutes a permissible deduction in terms of section 11(a), capital expenditure does not. The basic facts were that the taxpayer expended sums of money on sewage works required by the implementing of a local by-law. Part of the sewage works were built on the taxpayer's property while the rest were built external to the taxpayer's property. The sewage works built on the property of the taxpayer were considered, in terms of the agreement with the local municipality, to be part of the taxpayer's property while the external sewage works would never be considered part of the taxpayer's property. The taxpayer attempted to deduct both the expenditure on the internal sewage works and the external sewage works. The Commissioner argued that the attempted deductions were both invalid due to the fact that capital expenditure was incapable of deduction.

Once again Watermeyer's use of illustration and examples in demonstrating applicable concepts is noticeable. The concept of floating capital as opposed to fixed capital, for instance, was explained with reference to an example. Without the use of such an example this concept may well have proven to be confusing. After isolating the problem at hand which was, essentially, the determination of the difference between expenditure incurred "as part of the cost of performing the income-earning operations" and expenditure aimed at "establishing or improving or adding to the income-earning plant or machinery," Watermeyer went on to analyse a host of authority on the matter before coming to a conclusion which has been quoted by innumerable subsequent courts, academics and textbooks alike. The following passage, which is the passage most often quoted from this decision, is what, in the words of Wright, ensured Watermeyer's "place in the pantheon of South African tax law":

The conclusion to be drawn from all of these 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. Its true nature is a matter of fact and the purpose of the expenditure is an 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.

It is this passage that concluded Watermeyer's comprehensive interpretation of what is now known as section 11(a) of the Act. The *Joffe* decision remains authoritative on the difference (if any) between 'expenditure' and 'losses' while the *PE Electric* decision is the leading authority on the interpretation of 'actually incurred in the production of income.' The final part of section 11(a) refers to the fact that capital expenditure is an impermissible deduction. The *New State Areas* decision is, without question, the leading authority on the difference between capital and revenue expenditure and, as such, completes the interpretation of section 11(a). Whilst no discernible evidence of a specific approach to statutory interpretation was found, it was suggested that this was substantially outweighed by the magnitude of the impact of this judgment. The diversity of application of this decision was also highlighted with respect to subsequent cases deciding whether a particular expenditure was capital or revenue in nature. This decision will continue to be the leading authority on the difference between revenue and capital expenditure. It is, furthermore, suggested that the diversity of applicability of the principles developed in this decision will grow as more novel situations or applications come to the fore.

The last case to be analysed was one of Watermeyer's lesser known judgments. The case of *CIR v King* together with the *Randles Brothers* decision was incorporated into this thesis due to their combined effect on the very important issue of tax avoidance. Whilst the latter dealt with the common law principles of tax avoidance, the *King* decision dealt with anti-avoidance legislation. The *King* decision dealt with the interpretation of section 90 of the 1941 Act. Section 90, as was stated above, was section 103(1)'s predecessor. Watermeyer critically analysed the section before deciding that a literal reading would lead to various absurdities. Such absurdity was once again explained with the use of several illustrative examples which provided the reader with a link between the technical explanation and the practical consequences resulting there from. The intention of the legislature was employed to determine the purpose behind the provision and in so doing it

became evident that a purposive-oriented approach was adopted in order to establish an equitable and logical interpretation of the section in question. The main achievement with respect to this decision, apart from its approach to statutory interpretation, was the interpretation given to the word ‘purpose’ as it stood in section 90 of the 1941 Act. In adopting the Provincial Division’s interpretation, it was held that by ‘purpose’ the legislature’s intention alluded to dominant or main purpose. This interpretation was formally adopted by section 103(1) and, thereafter, by section 80A of the latest general anti-avoidance provisions. Although there has been no reported case law on the interpretation of section 80A it was suggested above that the *King* decision may well be invoked to determine the correct interpretation when a dispute eventually arises. De Koker and Williams state that, although Watermeyer’s interpretations were with respect to section 90 of the 1941 Act, they “remain valid.” This is remarkable in the face of several legislative changes. Watermeyer’s influence with respect to both the common law principles of tax avoidance as well as the anti-avoidance provisions are complementary and provide a well-rounded contribution to this area of tax law.

Watermeyer made contributions across the legal spectrum during his time on the bench. Tax law, whilst probably his leading area of contribution, was by no means the only branch of law where he delivered leading and long-lasting judgments. He also delivered leading judgments in both delictual and criminal law. The focus in this thesis has, however, been on his influence with respect to tax law. This thesis has described and analysed his contributions to South African tax law without delving into the possibility of influence extending to other jurisdictions with similar taxing acts. This provides a possible avenue for further research. It would be a particularly interesting exercise to enquire into whether his judgments have been applied in other jurisdictions or failing this to investigate whether the interpretations delivered by foreign judges in other jurisdictions measure up to or compare with the interpretations established by Watermeyer. Obviously such interpretations could only be compared where the provisions of a foreign act are materially the same as our own. Such research would provide an interesting perspective as it would provide a measure with which to compare the interpretations developed by Watermeyer. One could, thereafter, analyse the

difference in interpretations between Watermeyer's and a particular foreign interpretation and examine the more meritorious or logical interpretation. This would, however, have to be undertaken in a manner where the different political purposes behind the particular provisions are taken into account bearing in mind that law mirrors society and every society is different.

Watermeyer is truly a 'giant of the South African judiciary' and should be celebrated and recognised as such.

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