A CRITICAL ANALYSIS OF THE PRACTICAL MAN PRINCIPLE IN *COMMISSIONER FOR INLAND REVENUE v LEVER BROTHERS AND UNILEVER LTD*

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ABSTRACT

This research studies the practical person principle as it was introduced in the case of *Commissioner for Inland Revenue v Lever Brothers and Unilever Ltd* 1946 AD 441. In its time the *Lever Brothers* case was a seminal judgment in South Africa's tax jurisprudence and the practical person principle was a decisive criterion for the determination of source of income. The primary goal of this research was a critical analysis the practical man principle. This involved an analysis of the extent to which this principle requires judges to adopt a criterion that is too flexible for legitimate judicial decision-making. The extent to which the practical person principle creates a clash between a philosophical approach to law and an approach that is based on common sense or practicality was also debated. Finally, it was considered whether adopting a philosophical approach to determining the source of income could overcome the problems associated with the practical approach.

A doctrinal methodology was applied to the documentary data consisting of the South African and Australian Income Tax Acts, South African and other case law, historical records and the writings of scholars.

From the critical analysis of the practical person principle it was concluded that the anthropomorphised form of the principle gives rise to several problems that may be overcome by looking to the underlying operation of the principle. Further analysis of this operation, however, revealed deeper problems in that the principle undermines the doctrine of judicial precedent, legal certainty and the rule of law. Accordingly a practical approach to determining the source of income is undesirable and unconstitutional.

Further research was conducted into the relative merits of a philosophical approach to determining source of income and it was argued that such an approach could provide a more desirable solution to determining source of income as well as approaching legal problems more generally.

Key Words:
Lever Brothers, source of income, practical man, practical person, reasonable person, two-step framework, judicial certainty, judicial precedent, legality, the rule of law, philosophy and practicality.

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CHAPTER 1: INTRODUCTION

> *[The practical man] would indicate that the obvious thing to do would be to ask a lawyer.*
>
> – Schreiner JA, *Lever Brothers*

> *I have some difficulty in differentiating the reasoning of the practical man from that of the theoretical lawyer.*
>
> – Watermeyer CJ, *Lever Brothers*

1.1. CONTEXT OF THE RESEARCH

One of the seminal decisions in South African tax jurisprudence is *Commissioner for Inland Revenue v Lever Brothers and Unilever Ltd* (*Lever Brothers*).[1] This decision of the Appellate Division established the precedent for determining the source of income and has been cited with approval by a number of South African and international courts. Under the source-based system of taxation, which South Africa adopted until 2001, finding the source of income was a necessary prerequisite for taxation. Despite the adoption of section 9 of the Income Tax Act,[2] which changes the manner in which the source of certain classes of income is determined, the *Lever Brothers* judgment remains instructive for certain matters more than 65 years after it was heard. In coming to their decision in the *Lever Brothers* case, however, the three judges of appeal arrived at different conclusions. The basis of their departure appears to be their application of the "practical man"[3] principle to the facts of the case.

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[1] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441.

[2] South African Income Tax Act 58 of 1962.

[3] The term "practical man" is a problematic relic of historical sexism. Although the sexed language of this concept would likely be interpreted to include both sexes, this would not always have been the case. The fictional case of *Fardell v Potts*, by AP Herbert (1989) *Misleading Cases on the Common Law* 4ed Buffalo: William S Hein & Co Inc., illustrates the difficulties of not having a "reasonable woman" standard. This writer is, however, skeptical that true equality can be reached by placing emphasis on "identity characteristics" of men and women (V Nourse "After the Reasonable Man: Getting over the Subjectivity/Objectivity Question" (2008) 11(1) *New Criminal Law Review* 33). The writer is even more concerned that the endurance of sexed language in modern discourse contributes to persisting sexist ideologies. One of the ways this is achieved is by constructing the "male" as *general* and references to the "female" as *particular*. Furthermore, such references contribute to the false dichotomy that sex is a binary phenomenon. This paper, therefore, uses the sex-neutral term "practical person" and the writer has attempted to avoid the use of sexed pronouns where practicable. A singular

The *Lever Brothers* case concerned the taxation of income received by a non-resident company, Lever Brothers and Unilever Ltd, situated in England. This income was in the form of interest on a loan to the value of approximately £11,000,000 that was initially lent to a company situated in the Netherlands. This loan was then ceded, along with the obligation to pay interest, to a South African company. The South African company, however, never took possession of the shares in an American company, which were at all times held in trust by an English company as security for the loan. The South African company was nevertheless responsible for the interest on the loan, which it duly paid out of dividends on the shares. The question for the judges in the *Lever Brothers* case was whether or not the interest received by Lever Brothers and Unilever Ltd in England was from a source within the what was then the Union of South Africa and, therefore, subject to tax in South Africa.

In order to come to their decision, all of the judges in *Lever Brothers* accorded a certain weight to the practical person principle in applying it to the facts of the case. The genesis of this principle as a tool for determining the source of income was in the Australian case of *Nathan v FCT* (*Nathan*),[4] where Isaacs J held that source is not "a legal concept, but something which a practical man would regard as a real source of income." This dictum was then quoted with approval by Lord Atkin in the Privy Council decision of *Rhodesian Metals Ltd (in Liquidation) v COT*.[5] The effect of Lord Atkin's judgment, according to *Lever Brothers*, was to create binding authority within South Africa and bring the practical person principle into South African law.

1.2. PURPOSE AND IMPORTANCE OF THE RESEARCH

It has been argued by a number of authorities[6] that it is impossible to lay down precise rules for the determination of the source of income. The purpose of the practical

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"they" has, therefore, been adopted in certain instances. References to other writers have, however, been left unchanged. It would be cumbersome to highlight the sexed language used in each quotation, but this does not mean that the writer condones the use of such language.

[4] *Nathan v FCT* (1918) 25 CLR 183 186.

[5] *Rhodesian Metals Ltd (in Liquidation) v COT* 1940 AD 432.

[6] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 454; J Balazs "An Introduction to Australia's Tax System: How Source is Determined" (2009) 7 http://www.blwllp.com/getattachment/a00ed84b-b7b8-429a-b39f-2e875a91e6a6/How-is-Source-Determined--.aspx (accessed 8 May 2013); AJ Halkyard "Hong Kong Profits Tax: The Source Concept: Part 1" (1990) 20(2) *Hong Kong Law Journal*

person principle is, therefore, to facilitate the attainment of an equitable result by allowing judges to decide cases on a case-by-case basis with deference to the views of ordinary people.[7] In a sense the practical person provides a lens of practicality through which the ordinary legal framework must be viewed.[8] In line with this, Halkyard[9] notes that the practical person "allows judges to ignore technical rules which would otherwise dictate that source lies in an absurd place." In a narrow sense, the practical person principle justifies the court's ability to have regard to the substance of a matter over its form.[10] The broad effect of the practical person principle, however, is that it imposes an "extremely flexible"[11] criterion on which cases must be decided. Kuan[12] notes that this flexibility does not give judges adequate guidance with the result that "it is possible for the courts to go astray."

In the *Lever Brothers* case, the flexibility inherent to the practical person principle resulted in a situation where each of the judges was able to take a completely different approach to locating the source of the income in question. While judicial discord is not necessarily problematic in and of itself, it may be an indication of a deeper trouble with the tools used in the judicial decision-making process. The use of the practical person principle as a criterion for judgment clearly makes the outcome of cases less predictable in advance since the decision is no longer predicated on an application of the law but rather on the discretion of the judges. The effect of this, paradoxically, is to undermine the very reason for which the practical person principle was introduced in the first place: that is, to arrive at decisions that are more consistent with the public's perception of the law. Instead, the application of the practical person principle results in cases that are less predictable. The result of this is that legal certainty and the principle of judicial precedent are undermined. Since legal certainty

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232 at 241; LH Kuan "Determining Sources of Income – A New Guiding Principle?" (1991) *Singapore Journal of Legal Studies* 517 at 519-520; LH Kuan "Income Tax – Source Principle Refined" (1992) *Singapore Journal of Legal Studies* 566 at 571.

[7] M Wills "The Income Tax Implications of a Foreign Individual Contracting to do Business in Australia, with Particular Reference to Concepts of 'Residence' and 'Source'" (1997) 9(1) *Bond Law Review* 34 at 47; *FCT v United Aircraft Corporation* (1943) 68 CLR 525 538.

[8] Kuan 1991 *Singapore Journal of Legal Studies* 520, where it is argued that the legal framework must be seen "through the eyes of the practical man." J Balazs "An Introduction to Australia's Tax System: How Source is Determined" (2009) 7 http://www.blwllp.com/getattachment/a00ed84b-b7b8-429a-b39f-2e875a91e6a6/How-is-Source-Determined--.aspx (accessed 8 May 2013).

[9] Halkyard 1990 *Hong Kong Law Journal* 242.

[10] TW Liang "The Source of Interest: Section 10 and Section 12(6) of the Income Tax Act" (1988) 30 *Malaya Law Review* 393 at 399.

[11] Kuan 1991 Singapore Journal of Legal Studies 520.

[12] Kuan 1991 Singapore Journal of Legal Studies 520.

is a requirement of the principle of legality and, therefore, the rule of law, the result is one that is not only unconscionable but also unconstitutional. This is because it violates section 1(c) of the constitution,[13] which states that the rule of law is one of South Africa's founding values.

The incorporation of the practical person principle as a tool for judicial decision-making in South African law, it is argued, has not facilitated legal certainty and effective decision-making on the part of judges. Instead, it would appear that the flexibility inherent in this construction allows judges to be less rigorous in their application of the law than they are required to be. The consequence of this is that the practical person becomes a tool that may be easily co-opted as a substitute for judges' personal opinions in the guise of a legitimate application of the law.

Davis AJA in *Lever Brothers* seems to define the practical person in contrast to the philosophical person. Over and above this, it will be shown that the practical person is intended to exemplify "common sense" and pragmatism rather than the pedantry associated with legal/philosophical reasoning. Russell[14] and Chesterton[15] on the other hand, argue for the merits of philosophical enquiry. This research will demonstrate that the failure of the *Lever Brothers* decision to achieve legal certainty may be construed as an indication of the inadequacies of "common sense" reasoning and is instead a call to a more rigorous philosophical enquiry.

This research will, therefore, expand the scope of this thesis beyond issues of the source of income and will ask questions about the correct approach to judicial decision-making and South Africa's jurisprudence more generally.

1.3. RESEARCH OBJECTIVES

The primary goal of this research is to critically analyse the practical person principle. This will be achieved principally by evaluating it in the context of the *Lever Brothers* case. More generally, this concept's reception in a number of foreign jurisdictions as a tool for determining the source of income will also be examined. In order to assist this

[13] The Constitution of the Republic of South Africa, 1996.
[14] B Russell *The Problems of Philosophy* (1959).
[15] GK Chesterton *The Common Man* (1950).

analysis, parallels will be drawn between the practical person of taxation jurisprudence, and the reasonable person of criminal law[16] and the law of delict.

In the process of achieving the primary goal set out above, a number of sub-goals will be addressed.

- First, it will be necessary to evaluate the extent to which the practical person principle requires judges to adopt a criterion that is too flexible for legitimate judicial decision-making.
- Second, the practical person principle will be evaluated against its ability to promote legal certainty, the principle of judicial precedent and the rule of law.
- Third, the extent to which the practical person principle creates a clash between a philosophical approach to law and an approach that is based on common sense or practicality will be debated.
- Finally, by adopting a philosophical approach to determining the source of income, a test that overcomes the problems of legal certainty and inequity outlined above will be sought.

1.4. RESEARCH METHODOLOGY AND DESIGN

An interpretative research approach is adopted for the present research as it seeks to understand and describe.[17] The research methodology to be applied can be described as a doctrinal research methodology. This provides a systematic exposition of the rules and approaches governing a particular legal category (in the present case, the legal rules relating to the determination of the source of one's income and the application of the practical person principle), analyses the relationships between the rules, explains areas of difficulty and is based purely on documentary data.[18]

[16] V Nourse "After the Reasonable Man: Getting over the Subjectivity/Objectivity Question" (2008) 11(1) *New Criminal Law Review* 33.
[17] E Babbie and J Mouton *The Practice of Social Research* (2009) Oxford University Press Southern Africa: Cape Town.
[18] MA McKerchar "Philosophical Paradigms, Inquiry Strategies and Knowledge Claims: Applying the Principles of Research Design and Conduct to Taxation" (2008) *eJournal of tax Research* 1 http://www.austlii.edu.au/au/journals/eJTR/2008/1.html (accessed 4 October 2013).

This will involve an analysis of various forms of documentary data including:

- income tax legislation;
- relevant case law, including cases from South Africa, Australia, New Zealand, Hong Kong and Singapore, where the practical person concept has been used and commented upon;
- historical records, to the extent that it will provide insight into the backgrounds of the judges in *Lever Brothers* and may provide an explanation for some of their decisions and/or approaches to this case; and
- writings of experts in the field to provide the framework against which the practical person principle may be critically evaluated.

A doctrinal analysis of the "black letter" law will form the foundation of the analysis and will involve the interpretation of relevant case law. Thereafter, a critical approach will be undertaken, incorporating the writings of various experts and historical texts. This critical approach will provide the substance of the positive argument.

The research is conducted in the form of an extended argument, supported by documentary evidence. The validity and reliability of the research and the conclusions will be ensured by:

- adhering to the rules of the statutory interpretation, as established in terms of statute and common law;
- placing greater evidential weight on legislation, case law which creates precedent or which is of persuasive value (primary data), and the writings of acknowledged experts in the field;
- discussing opposing viewpoints and concluding, based on a preponderance of credible evidence; and
- the rigour of the arguments.

Since the research required for this paper only necessitates an analysis of documentary data, all of which is in the public domain, no ethical considerations arise. Interviews will not be conducted; opinions will be considered in their written form.

It must also be mentioned, further, that the purpose of this paper is to examine and critique the *Lever Brothers* case and the practical person principle. At various points, the reasoning and decisions of the judges in *Lever Brothers* and in other cases have, therefore, been subjected to critique. This critique is not intended deride the particular judges. It is recognised that judges must do the best they can, given the limited time available to them and the strict rules of the judicial decision-making process. In writing this paper, such limitations have not arisen. Instead, the writer has had the benefit of abundant time and the opportunity to discuss the matter with a number of people. Over and above this, the advent of constitutionalism and the purposive approach to statutory interpretation in South Africa have provided the writer with tools that would not have been available to many of the judges referred to. These tools have greatly facilitated this critique and the positive argument presented.

1.5. OVERVIEW OF THE RESEARCH

The foundation of this research is the *Lever Brothers* case which incorporated the practical person principle into South African law. A detailed overview and critical analysis of this case are, therefore, undertaken in Chapter 2 in order to properly contextualise this important judgment. This involves a description of five key aspects of the judgment: the facts of the case; the issue before the judges; the legal framework used by the judges; the judgments of each of the judges and, finally, a description of how the practical person principle was used in the case. This analysis is undertaken with a view to properly describing the framework into which the practical person principle was crafted.

Against the milieu of the *Lever Brothers* judgment the practical person principle appears as a decisive factor in matters requiring a determination of source of income. Chapter 3, therefore, sets out to analyse this principle in greater detail. In this process the history of this principle is traced back to its formation in Australia in the early 1900s, and a brief comparative analysis is undertaken of the use of this principle in other jurisdictions, particularly in Hong Kong, Singapore and Australia.

The key advance made in Chapter 3 is a discussion of the purpose for which the practical person principle was introduced. In this regard an analysis of the early

source of income cases shows that the Legislature intended the source of income to be determined practically. This is largely because it was considered impossible to construct an ultimate definition of source of income. This problem also spilled over into the two-step framework that Watermeyer CJ established in *Lever Brothers*. A flexible tool was, therefore, required in order to facilitate a *practical* approach to the particular *facts* of each case and prevent the possibility of unjust results. This tool was the creation of the practical person principle. This conclusion is evidenced with a reference to scholarly writing from Hong Kong and Singapore where their frameworks for determining source of income were not developed in parallel with their adoption of the practical person principle.

Given the role that the practical person principle is crafted to fulfil, it becomes possible to elucidate a number of "characteristics" of this hypothetical person. The second half of Chapter 3 is, therefore, devoted to this purpose. In particular it is contended that the practical person must be a flexible criterion that facilitates giving precedence to the substance of a matter over its form; disregarding technical legal rules; aligning the law with public perceptions; and, above all, a practical – rather than philosophical – approach to judicial decision-making.

The discussion of the true operation of the practical person principle in Chapter 3 reveals a number of problematic repercussions. It appears, therefore, that in rectifying the problems associated with the source of income inquiry, the practical person principle proves to be a "double-edged sword." Chapter 4, therefore, sets out to examine the negative consequences of the practical person principle in greater detail. In particular two broad categories of problems are identified: those that arise out of the form of the principle, and those that arise out of its substance.

The first category of problems arises out of the way the principle was described in the *Lever Brother*s case. In particular that it is an anthropomorphisation of the underlying aspects of the source of income enquiry: practicality and factual-precedence. These problems can, consequently, be removed by describing the principle differently. In particular, by looking to the true operation of the principle – as a tool to restrain the overzealous application of the law – the personification can be removed without negating the underlying operation of the principle. In this manner, the problems with

the source of income inquiry identified in Chapter 3 continue to be overcome without creating the additional problems arising out of the anthropomorphised principle.

The latter category of problems, however, arises out of the substance of the practical person principle. These problems are, therefore, independent of the guise that is given to the principle. This is because these problems arise out of the approach that is taken to determining source of income: that it must be assessed factually and practically. In particular two key problems are discussed: that the principle cannot deal with complex legal issues and that it offers an unduly flexible criterion for judicial decision-making.

The latter part of Chapter 4 is devoted to an exposition of the down-stream consequences of these problems. In particular, it is argued that this approach undermines key aspects of our justice system including the doctrine of judicial precedent; prospective application of the law; legal certainty; legality and the rule of law.

The problems with the overall approach discussed in Chapter 4 are shown to be the result of the initial decision that determining the source of income should not be subject to an ultimate test. It is out of this decision that the problematic practical approach was conceived. By questioning this foundational assumption, Chapter 5 sets out to evaluate the relative merits of an approach that is predicated on philosophy – characterised by impersonal, abstract and universal thought – rather than practicality, which is based on concrete notions of common sense and custom. The method used in *Kergeulen Sealing and Whaling Co Ltd v CIR*[19] is then evaluated against its ability to provide a definitive test for determining source of income that is predicated on a philosophical evaluation of the legal nature of source of income. Finally this test is evaluated against its application to the facts of the Lever Brothers case. It is concluded that, by proceeding from a philosophical analysis of the principles of source of income, a test can be developed that overcomes the problems that were discussed in Chapters 3 and 4. In this way, an ultimate test for determining source of income is proposed.

[19] *Kergeulen Sealing and Whaling Co Ltd v CIR* 1939 AD 487.

Finally, Chapter 6 revisits the goals of this thesis and summarises the key conclusions drawn, assessing the extent to which these objectives have been achieved. Throughout this process certain topics that were beyond the scope of this research are highlighted. In some cases these limitations present opportunities for future research; these are highlighted where appropriate.

By illustrating the flaws of a solely practical approach to judicial decision-making, this thesis argues for a more rigorous philosophical approach to the law.

CHAPTER 2: THE LEVER BROTHERS CASE

> *The purpose of all these manoeuvres is not quite clear. Probably the substitution… was effected in order to avert certain consequences which were foreseen if Holland were occupied by the enemy.*
>
> – Watermeyer CJ, *Lever Brothers*

2.1. INTRODUCTION

The opportunity to make a final delineation on the issue of when tax should be paid in South Africa arose in the *Lever Brothers* case.[20] In many respects the court seized this opportunity and the resulting judgment became the definitive authority[21] in this regard until 1998 when amendments to the Income Tax Act[22] created specific rules for this question. This case is, therefore, rightly regarded as a seminal judgment in South African tax jurisprudence and still finds application today. Despite its importance, however, closer examination of *Lever Brothers* reveals certain key principles laid down by the court to be deeply problematic.

This chapter will discuss the *Lever Brothers* judgment as a precursor to an evaluation of the practical person principle that will follow in Chapter 3. This discussion will involve an analysis of five key aspects of the judgment. First, the facts of the case will be set out in order to properly contextualise the judgment. Second, the problem that arose in the judgment will be identified and discussed. Third, the framework used by the judges will be briefly outlined. Fourth, a short discussion of each of the judges' application of this framework to the facts of the case will be conducted in order to illustrate their discordance. Finally, a short description of their differing applications of the practical person principle will be undertaken.

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[20] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441.
[21] R Thackwell *The Contribution Made by Mr Justice EF Watermeyer to South African Tax Jurisprudence* (Unpublished Masters Thesis, Rhodes University 2010) 75.
[22] Section 25(1)(b) of the South African Income Tax Act 30 of 1998.

2.2. FACTS OF LEVER BROTHERS

The *Lever Brothers* case arose out of tax assessments for the years 1940 to 1942 in which two English companies, Lever Brothers and Unilever Ltd (Levers) and Associated Enterprises Ltd were assessed on income received within the Union of South Africa. The English companies disputed the assessment and took the matter to the Special Income Tax Court, which found in their favour.[23] The *Lever Brothers* case arose out of an appeal from this decision by the South African Commissioner for Inland Revenue.

In setting out the facts of the case, Watermeyer CJ in *Lever Brothers* notes that the parties had agreed to be bound by a decision based only on the facts as they relate to Levers.[24] This is because Associated Enterprises Ltd, a subsidiary of Levers, was in a materially similar position. The outcome of the case would, therefore, settle the dispute for both companies.

At the heart of the case were two agreements entered into in Rotterdam, Holland, between Levers and Maatschappy voor Internationale Beleggingen N.V (Mavibel) in 1937 and 1939. Mavibel was a Dutch company with its registered office in Rotterdam. These agreements were, as Watermeyer CJ noted euphemistically, "somewhat involved."[25] The overall effect of which was a sale of certain assets from Levers to Mavibel. Mavibel in return would be liable for £11,000,000, which would be repayable before the end of 1961, and interest was payable annually on the amount due. Mavibel also agreed to furnish security for the debt by transferring roughly £11,800,000 worth of shares to a trustee. The company that would act as trustee was The Whitehall Trust Ltd, an English company, which would hold the shares on behalf of Mavibel.[26]

In 1940, a number of new agreements were entered into. These agreements had the effect of transferring the rights and obligations of Mavibel, outlined above, to Overseas Holdings Pty Ltd (Overseas Holdings), a South African company with its

[23] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 444.
[24] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 444.
[25] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 445.
[26] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 445.

head office in Durban.[27] Subject to some modifications, Overseas Holdings essentially stepped into the shoes of Mavibel and between 1940 and 1943 proceeded to pay the interest it owed to Levers at their registered office in London.

It is to be noted that part of the move to South Africa involved an agreement with the South African Treasury that no interest or capital would be paid out of South African funds.[28] In accordance with this, all interest payments were made to Levers out of dividends received in respect of shares that Overseas Holdings owned in an American company.[29] At no point did the funds pass through South Africa.

The reason for the substitution was not made clear by the parties; however, Watermeyer CJ[30] and Schreiner JA[31] speculated that this was done "in order to avert certain consequences which were foreseen if Holland were occupied by the enemy (Germany)."[32] From the scheme of the original contractual provisions entered into in 1937, it would seem that the event of war in Europe was foreseen and certain measures put in place in anticipation of this. The move from Holland (shortly before it was invaded by Germany) to South Africa was, therefore, consistent with this strategy.

The Commissioner of Inland Revenue then assessed Levers on the interest it had received from Overseas Holdings on the basis that it was earned from a source within the Union of South Africa.[33]

2.3. THE ISSUE

The question before the court was whether or not the interest income earned by Levers was taxable under the South African Income Tax Act (the Act).[34] More specifically, the issue related to a consideration of whether this income ought to be

[27] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 461.
[28] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 465.
[29] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 448.
[30] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 448.
[31] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 461.
[32] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 448.
[33] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 448.
[34] South African Income Tax Act 31 of 1941.

regarded as being from a source within South Africa.[35] At this time, South Africa operated under a source based system of taxation.

2.4. THE WATERMEYER CJ FRAMEWORK

The starting point for Watermeyer CJ in *Lever Brothers* was the statute that entitled the state to collect taxes on income.[36] It must be remembered that at this time the Union of South Africa was under a system of parliamentary sovereignty. One of the effects of this was that judges had little scope to question duly passed acts of parliament. This system heavily influenced the dominant approach to statutory interpretation, and resulted in a preference of the literalist/intentionalist approach, as well as deference to the superior power of parliament. This approach was echoed at the beginning of Schreiner JA's judgment where it is noted that the concern of the court was "solely with the application of statute, properly construed; to facts properly analysed and assessed."[37]

The relevant section of the Act for the *Lever Brothers* decision was the definition of "gross income." Importantly, the Legislature set out to include in gross income amounts earned "from a source which is within the Union or which is deemed to be within the Union."[38] The term "source" was, however, not defined in the Act.[39] This meant that it was left to judicial pronouncements to clarify its meaning. In consulting these judgments, Watermeyer CJ confirmed the approach taken in *Overseas Trust Co Ltd v CIR*[40] and *COT v Dunn & Co*[41] that "source" refers to the *origin* of income and not its *location*.[42] Watermeyer CJ held further that these and other decisions led to the inference 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."[43]

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[35] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 449.
[36] The Income Tax Act 31 of 1941.
[37] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 457.
[38] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 449.
[39] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 457.
[40] *Overseas Trust Co Ltd v CIR* 1926 AD 444.
[41] *COT v Dunn & Co* 1918 AD 607.
[42] *Overseas Trust Co Ltd v CIR* 1926 AD 444 453.
[43] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 450.

An important consequence of describing source as the *origin* of income rather than its *location* is that it allowed Watermeyer CJ to separate these two, often conflated, concepts. The effect is what has become lauded as "Watermeyer's two pronged test."[44] Describing it as a "test," however, does not accurately convey the true operation of Watermeyer CJ's approach. The two questions cannot be asked in the alternative, nor are they different methods to be applied to the same question. A similar problem arises in Haupt's description of the approach as having two "factors."[45] This implies that the two questions ought to be weighed together to contribute to the final outcome. This again is incorrect. The approach which comes closest to the mark, therefore, is the description in *Silke: South African Income Tax* as a "problem [that] involves an enquiry into two matters."[46] It is clear from the judgment that Watermeyer CJ delineated a stepped approach that *requires* an answer to both questions in the *order* that they are posed. This is Watermeyer CJ's two-step framework and it was the first meaningful guide to determining source of income in South Africa's tax jurisprudence.

Although a framework with which to evaluate the source of income had been established, this was by no means the end of the enquiry. What remained to be done was to apply this framework to the case at hand. In this process, Watermeyer CJ cited with approval a passage from the Australian case *Nathan v FCT* (*Nathan*):[47]

> 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.

This maxim arose out of an interpretation of the decision in *Mitchell (Surveyor of Taxes) v Egyptian Hotels Ltd*[48] where the court had regard to source of income as "a question of fact." The important contribution of the court in *Nathan*, therefore, was to expand this approach considerably. The result was a guiding principle that was

[44] R Thackwell *The Contribution Made by Mr Justice EF Watermeyer to South African Tax Jurisprudence* (Unpublished Masters Thesis, Rhodes University 2010) 88.
[45] P Haupt *Notes on South African Income Tax* 32 ed (2013) 37.
[46] L van Schalkwyk "Residence and Source" in M Stiglingh (ed) *Silke: South African Income Tax* (2013) 65.
[47] *Nathan v FCT* 25 CLR 183 186.
[48] *Mitchell (Surveyor of Taxes) v Egyptian Hotels Ltd* [1915] UKHL 2 2, 7.

intended to inform all decisions involving questions of source of income. This was the practical person principle.

After it was applied in the *Nathan* decision, the practical person principle was quickly accepted by the Privy Council[49] and subsequently spread to a number of jurisdictions including Hong Kong,[50] New Zealand[51] and South Africa.[52]

2.5. THE THREE JUDGMENTS IN *LEVER BROTHERS*

2.5.1. WATERMEYER CJ

Watermeyer CJ began with an application of the legal framework to the facts in *Lever Brothers* by attempting to determine the originating cause of interest income. In this regard, a largely legal/philosophical analysis of a debt was undertaken. Watermeyer CJ held 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.[53]

The colloquial expression that a debt is located where the debtor resides was, concluded Watermeyer CJ, a metaphor that did not adequately settle the current issue.[54] By comparing a loan of money to the lease of property, Watermeyer CJ was able to hold that the true originating cause of interest income was the provision of credit by the lender.[55]

The next, and more difficult, task was to locate the source of income. In this regard, Watermeyer CJ undertook a detailed analysis of a number of cases that had dealt with

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[49] *Rhodesian Metals Ltd (in Liquidation) v COT* 1940 AD 432.
[50] *CIR v Hang Seng Bank Ltd* [1990] UKPC 42.
[51] *CIR v N.V. Philips Gloeilampenfabrieken* (1954) 10 ATD 435 in J Balazs "An Introduction to Australia's Tax System: How Source is Determined" (2009) 7 http://www.blwllp.com/getattachment/a00ed84b-b7b8-429a-b39f-2e875a91e6a6/How-is-Source-Determined--.aspx (accessed 8 May 2013).
[52] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 454.
[53] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 449.
[54] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 456.
[55] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 451.

the location of the source of income in various situations.[56] This analysis allowed a number of relevant factors to be drawn from the totality of the factual matrix in *Lever Brothers*. These factors included the following: that no contract was signed in South Africa; no property was situated in South Africa; the sale took place in England; the obligations under the contract were performed in England; no business was carried out in South Africa; no capital was employed in South Africa; no services were rendered in South Africa; and no obligations were to be performed in South Africa. From this, Watermeyer CJ concluded that no activities were performed in South Africa and, therefore, that the income was not from a source within South Africa.[57]

In sum, Watermeyer CJ adopted a negative approach, showing that each aspect of the transaction could not be attributed to South Africa and that, therefore, the source of the income must have been located outside of South Africa. He did not, however, conclude that the place where the credit was made available established the location of the source.

The essence of Watermeyer CJ's approach up to this point is most accurately described as legalistic in nature. Much emphasis was placed on a correct understanding of legal metaphor, as well as correctly understanding the legal rules that fictionally situate incorporeals at a certain physical location. As was his custom,[58] Watermeyer CJ also undertook a thorough exploration of the relevant authorities and accepted legal rules.

In justifying this conclusion, however, Watermeyer CJ examined an additional line of reasoning. Perhaps recognising the potential discordance between his legalistic reasoning and the opinion of the practical person, Watermeyer CJ stated that he had "some difficulty in differentiating the reasoning of the practical man from that of the theoretical lawyer for this purpose."[59] His conclusion, therefore, held not only in law but also, conveniently, in practical reality.

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[56] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 451-455.
[57] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 456.
[58] R Thackwell *The Contribution Made by Mr Justice EF Watermeyer to South African Tax Jurisprudence* (Unpublished Masters Thesis, Rhodes University 2010).
[59] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 457.

2.5.2. SCHREINER JA

The approach taken by Schreiner JA in *Lever Brothers* was similar to Watermeyer CJ's in that it was primarily legalistic in nature. Schreiner JA started by describing three types of income: income from personal activities, income from the use of one's property, and income from a combination of the two. Applying this to the case at hand, Schreiner JA made three important findings. First, that the taxpayer did not earn the income in question because of the activities it conducted but simply from the loan of property.[60] Second, that the place where the contract was signed, as well as the place where the interest was due, were irrelevant for the present enquiry.[61] Third, that the interest on a loan was analogous to that of the fruits of property. Therefore, the interest income was derived from the loan amount and must, accordingly, be located with this amount.[62] In other words, Schreiner JA held that the originating cause of the income was the loan and that the loan is correctly located with the debtor.

Schreiner JA proceeded to support this conclusion with reference to *English, Scottish and Australian Bank Ltd v Commissioner for Inland Revenue*[63] in which it was held that a debt is located where the debtor resides.

In *Lever Brothers*, Overseas Holdings acquired the rights and obligations of Mavibel with the consent of Levers and became the debtor. The location of the loan amount must, therefore, be the residence of Overseas Holdings. Since Overseas Holdings was incorporated in South Africa, with the majority of its directors resident in South Africa and with it conducting its business meetings out of its head office in South Africa, it was accordingly located in South Africa.[64] The source of the interest income was, therefore, in South Africa.

In coming to this decision Schreiner JA made a number of references to the views of the "practical business man."[65] The difficulty Schreiner JA had in reconciling the reasoning set out above with the views of the practical person centred on the

[60] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 458.
[61] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 460.
[62] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 460.
[63] *English, Scottish and Australian Bank Ltd v Commissioner for Inland Revenue* 1932 AC 238 246 in *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 462.
[64] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 461.
[65] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 462.

artificiality of having to locate a debt. It was noted that this had to be done by way of legal fiction, which was, therefore, outside of the grasp of the practical person.[66] Schreiner JA, however, held that the practical person would realise, once the situation was explained to them, that locating an incorporeal in space is necessary.[67] Presumably their lawyer would explain this.[68]

Despite the above, Schreiner JA was confident that the practical person,

> would be surprised if he were informed that the source of interest on a longterm loan was the contract, made possibly decades ago, and not the loan debt itself.[69]

Schreiner JA did, however, add the caveat that a practical person would probably do the obvious thing, which is to ask a lawyer.[70]

Overall, therefore, the approach of Schreiner JA in applying the law to the facts was similar to that of Watermayer CJ in three material respects. First, they both proceeded from a legalistic argument to come to a *preliminary* conclusion. Second, they both used the concept of the practical person (albeit different incantations of it) to support their legal findings. Third, where they did not feel comfortable that the findings of the practical person would align with their own legally derived conclusions, they simply equated the two. Watermeyer CJ did this expressly while Schreiner JA did this impliedly, suggesting that the practical person would defer to legal advice.

2.5.3. DAVIS AJA

The conclusion Davis AJA reached was in line with Watermeyer CJ's; however, they differed radically in their reasoning. Of the three judges, Davis AJA was the only one that proceeded strictly from the position of the practical person and not with a legal foundation. Davis AJA framed the conception of the practical person as a "test" that the court was "bound to adopt."[71]

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[66] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 463.
[67] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 462.
[68] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 464.
[69] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 463.
[70] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 464.
[71] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 464.

Davis AJA's conclusion was, accordingly, based on two observations of what the practical person would consider correct in the present case. First, was that the practical person would conclude that the source of the income was either from the dividends in America or the granting of credit in England.[72] Deciding between these two locations would, however, be difficult for the practical person.

Second, that the practical person would be unable to find the source of the income to be in the Union since there had been an express agreement that no capital or interest from South African funds would leave South Africa. Therefore, since this provision had been complied with, it could not be said that South Africa was the source of the income.[73]

2.6. APPLICATION OF THE PRACTICAL PERSON PRINCIPLE

The most striking feature of the judgments set out above is that they were all manifestly different. The primary distinction between all of the judgments was their interpretation and application of the practical person. Accordingly, while Watermeyer CJ and Davis AJA reached the same conclusion on the outcome of the case (giving them the majority), they did this with different reasons. The essence of the judges' discordance can be summed up as follows: Watermeyer CJ held that the practical person would see that the common description of a loan being located where the debtor resides is metaphorical. Consequently the necessary process of reasoning, not dissimilar from that of the "theoretical lawyer,"[74] would then be taken to come to the conclusion that the true source of interest income was the granting of credit and, accordingly, not located in South Africa.

Schreiner JA, however, held that the practical person would have difficulty with the notion that an incorporeal must be located in space but that this would be resolved once the matter was properly explained and the person was assured that the Legislature required this.[75] From this, the practical person would probably think that the source of interest was the debt and accordingly located with the debtor. This was

[72] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 464.
[73] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 465.
[74] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 457.
[75] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 462-463.

in line with the legal reasoning Schreiner JA had already set out. Schreiner JA's final comment was that the practical person would probably indicate, when realising the complexity of this unusual transaction, that a lawyer should be consulted.

The practical person for Davis AJA was also a different creature altogether. This practical person would have put great weight on the agreement between Overseas Holdings and the Treasury. Given that both parties adhered to this agreement, and that no income or capital flowed from South Africa, the interest, therefore, cannot have been from a South African source.

2.7. CONCLUSION

The facts of the *Lever Brothers* case provided an unusually difficult challenge for the task of locating the source of income. The complexity of the situation was illustrated in both Watermeyer CJ's account of the facts of the case as well as the difficulty each of the judges had in placing the income in question. The case, therefore, involved an exploration of a number of different factors, many of which required an involved consideration of legal metaphor and fiction as well as the nature of an incorporeal debt. The unusual transactions entered into between Levers, Mavibel, The Whitehall Trust Ltd and Overseas Holdings provided fertile ground for a final delineation of the nature of source of income.

In many respects, the judges grasped this opportunity and the *Lever Brothers* decision became a seminal judgment in South Africa's tax jurisprudence. Through the creation of the two-step framework and the incorporation of the practical person into South Africa's law, the *Lever Brothers* case, and Watermeyer CJ's judgment in particular, became the ultimate authority for determining source of income.[76]

Further analysis of the *Lever Brothers* decision, however, reveals tensions between the three judgments. These tensions arose out of three different interpretations of the practical person principle and resulted in manifestly different approaches to the case.

[76] For cases referring to *Lever Brothers*, see for example: *CIR v Epstein* 1954 (3) SA 689 (A); *CIR v Black* 1957 (3) SA 536 (A); *COT v British United Shoe Machinery* (SA) (Pty) Ltd 1964 (3) SA 193 (FC); *COT v R* 1966 (2) SA 342 (RA); *Tuck v CIR* 1988 (3) SA 819 (A); *Essential Sterolin Products (Pty) Ltd v CIR* 1993 (4) SA 859 (A).

While Watermeyer CJ and Davis AJA agreed that the source of income was not located in the Union, giving them the majority, they did this for different reasons. Schreiner JA, on the other hand, came to a different conclusion altogether. Although judicial discord is not necessarily problematic in and of itself, it may be an indication of deeper trouble with the tools used in the judicial decision-making process. The use of the practical person principle as a criterion for judgment, and the apparent "source" of the judges' divergence will, therefore, be evaluated in the following chapter.

CHAPTER 3: THE PRACTICAL PERSON

> *For the person whom Lord Atkin had in mind was the practical man and not the legal theorist who, by resolutely shutting his eyes to all the facts, could prove that black was white*.
>
> – Davis AJA, *Lever Brothers*

3.1. INTRODUCTION

The *Lever Brothers* decision had the effect of bringing the practical person principle into South African law. Although this is not expressly stated in the judgment, the reasoning set out in Chapter 2 illustrates that this is clearly the case. Davis AJA was, accordingly, correct to state that the court was "bound to adopt the [practical person] test."[77] The *Lever Brothers* case can, therefore, be seen as a watershed decision for South Africa's tax jurisprudence, requiring that all subsequent inquiries into source of income apply the practical person principle.

This chapter will examine the inner workings of the practical person principle in greater detail. Accordingly, it will lay the foundation for Chapter 4 in which certain aspects of its operation will be critically examined. In order to properly understand the nature and operation of the practical person principle, it will be necessary to discuss two preliminary, and related, topics: first, the purpose for which the practical person principle was developed; second, a description of the practical person will be delineated in order to outline a broad definition of it. The discussion of these two topics will facilitate a greater understanding of the principle and will, therefore, underpin an exposition of the true nature of the practical person principle.

[77] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 464.

The goal of this chapter can, therefore, be summed up in the following passage by Chesterton:

> In the matter of reforming things, as distinct from deforming them, there is one plain and simple principle; a principle which will probably be called a paradox. There exists in such a case a certain institution or law; let us say, for the sake of simplicity, a fence or gate erected across a road. The more modern type of reformer goes gaily up to it and says, "I don't see the use of this; let us clear it away." To which the more intelligent type of reformer will do well to answer: "If you don't see the use of it, I certainly won't let you clear it away. Go away and think. Then, when you can come back and tell me that you do see the use of it, I may allow you to destroy it.[78]

The intent of this approach is to ward off unconsidered attacks at laws or institutions. It, therefore, requires that before a law or institution is removed, the purpose for which it was established must be thoroughly understood. This chapter will discuss the reason for the practical person principle before Chapter 4 attempts to "clear it away."

3.2. THE PURPOSE OF THE PRACTICAL PERSON

In the *Nathan* decision, it was made clear that the practical person principle arises out of a proper interpretation of Australian income tax legislation.[79] Specifically, it was stated that "[t]he Legislature in using the word 'source' meant, not a legal concept, but something which a practical man would regard as a real source of income."[80] Beyond this, however, primary sources of law do not provide much guidance on the operation of the practical person principle. In examining this principle, it is reasoned that the purpose for which it was introduced may facilitate a greater understanding thereof.

To borrow from the purposive approach to statutory interpretation,[81] the *mischief rule* may be used as a tool for examining the motivation behind the creation of the practical person principle.[82] The mischief rule operates by investigating the problem/s that the enactment was introduced to address as a method for understanding its

[78] GK Chesterton *The Thing* (1930) 15.
[79] Section 18 of the South African Income Tax Assessment Act 34 of 1915.
[80] *Nathan v FCT* (1918) 25 CLR 183 186.
[81] It must be noted that, although the practical person principle arises out of statute, it is not in itself a statutory enactment. It is, therefore, not necessary to make use of the tools of statutory interpretation. Accordingly, this paper uses these tools out of convenience only.
[82] L du Plessis *Re-Interpretation of Statutes* (2002) 248.

purpose.[83] For the present inquiry it may be used in a similar manner to find the purpose of the of the practical person principle. In this regard, an analysis of a number of texts that discuss the use of the practical person principle reveals two broad problems that this principle has been used to overcome. These will be discussed in turn below.

3.2.1. THE IMPOSSIBILITY OF A DEFINITIVE SOURCE OF INCOME TEST

The first problem is that it is considered, by a number of authorities,[84] to be impossible to lay down precise rules for the determination of source of income. In the first instance this position is supported by a number of cases. In *Lever Brothers*, it is noted that that Lord Atkin, in *Rhodesia Metals*, decided not to create a universal test that would operate in all source of income cases.[85] Following this, Watermeyer CJ commented that this would "probably [be] an impossible task."[86] Support for this conclusion can be found in *CIR v Hang Seng Bank Ltd* (*Hang Seng Bank*)[87] where the Privy Council held that, "[i]t is impossible to lay down precise rules by which… [source of income] is to be determined."

In South Africa, the Supreme Court of Appeal in *FNB v CIR*,[88] has recently confirmed this position, holding that Watermeyer CJ's evaluation of the totality of the facts in the *Lever Brothers* case would have been unnecessary[89] had a universal rule for the treatment of interest income been intended. Instead, if a universal rule, or test, were possible, it would have only been required that Watermeyer CJ ascertain the nature of the income in question and then apply the specific rule applicable to that form of income. This approach was clearly not undertaken.

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[83] L du Plessis *Re-Interpretation of Statutes* (2002) 96.
[84] *Commissioner for Inland Revenue v Lever Brothers and Unilever Ltd* 1946 AD 441 454; J Balazs "An Introduction to Australia's Tax System: How Source is Determined" (2009) 7 http://www.blwllp.com/getattachment/a00ed84b-b7b8-429a-b39f-2e875a91e6a6/How-is-Source-Determined--.aspx (accessed 8 May 2013); AJ Halkyard "Hong Kong Profits Tax: The Source Concept: Part 1" (1990) 20(2) *Hong Kong Law Journal* 232 at 242; LH Kuan "Determining Sources of Income – A New Guiding Principle?" (1991) *Singapore Journal of Legal Studies* 517 at 519-520; LH Kuan "Income Tax – Source Principle Refined" (1992) *Singapore Journal of Legal Studies* 566 at 568 and 571.
[85] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 454.
[86] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 454.
[87] *CIR v Hang Seng Bank Ltd* [1990] UKPC 42.
[88] *FNB v CIR* 2002 (3) SA 375 (SCA) para 18.
[89] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 455-456.

These cases make it clear that the weight of judicial authority is in favour of the position that a single test for the determination of source of income cannot be developed.

In the second instance, the cases of *CIR v Epstein*,[90] *Thorpe Nominees Pty Ltd v FCT* [91] and *Nathan*[92] conclude that it was the intention of the Legislature to avoid defining source of income too narrowly and instead deliberately left the term undefined. In this regard, the court in *CIR v Epstein*[93] held that the Legislature

> was probably aware of the difficulty in defining the phrase 'source within the Union' [and, therefore,] gave *no definition*. Consequently it is for the Courts to decide *on the particular facts of each case* whether 'gross income' has or has not been received from a source within the Union (emphasis added).

In the Australian case of *Thorpe Nominees Pty Ltd v FCT*,[94] it was similarly held that the word "source," as used in their Australian tax legislation,[95] "has no precise or technical reference." Furthermore, the *Nathan* decision[96] made it clear that the Legislature meant to use the word "source" as a practical concept, and not a legal concept from which precise rules would be developed.

This broad approach to the term "source of income" by the Legislature, in both South Africa and Australia, has clearly been an important factor that led the courts to the conclusion that a universal test for source of income cannot be developed. It would seem that this conclusion was anticipated by the Legislature and, from the pronouncements above, that the Legislature never intended that a universal test for source of income be developed. It is, therefore, submitted that it was the very intention of the Legislature that a broad case-by-case approach to determining source of income be adopted by the courts. It may be noted that, given the prevailing system of parliamentary sovereignty at this time, the intention of the Legislature would have been a vital consideration of the courts.

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[90] *CIR v Epstein* 1954 (3) SA 689 (A) 698C-D.
[91] *Thorpe Nominees Pty Ltd v FCT* 88 ATC 4886.
[92] *Nathan v FCT* (1918) 25 CLR 183 186.
[93] *CIR v Epstein* 1954 (3) SA 689 (A) 698C-D.
[94] *Thorpe Nominees Pty Ltd v FCT* 88 ATC 4886 4897.
[95] Australian Income Tax Assessment Act 34 of 1915.
[96] *Nathan v FCT* (1918) 25 CLR 183 186.

Returning to the *Lever Brothers* decision, support for the above contentions can be garnered from the fact that it clearly would have been untenable for Watermeyer CJ's judgment to become a final pronouncement on the source of interest income in general. This is because it would have meant that the proceeds from *all* loans to South African companies from outside of the Union would have to be regarded as from a source outside the Union. It is contended that this would be an absurd proposition. Instead, Watermeyer CJ himself noted that whether or not the company is carrying on business activities within the Union was of relevance.[97] He, therefore, clearly envisioned a situation in which, despite the loan being from a foreign country, the interest would have been taxed in South Africa. An example of this may be where credit is granted in order to fund business activities in South Africa. It is contended that such a situation would have likely led Watermeyer CJ to the conclusion that the interest income was from a source within the Union.

Despite the conclusion that a general rule for determining the source of income is impossible to create, a number of "guidelines" have evolved to deal with certain recurring issues. For example, regarding income from business operations, *CIR v Epstein*[98] applied the "activities test." Alternatively, in the case of employment income, the Special Tax Court has emphasised the importance of considering where the services were rendered.[99] For rental income from fixed property, the criterion that is usually decisive is the location of the property that is being leased.[100] The recognition of these guidelines gives rise to the second problem that the practical person principle was introduced to solve. That is the problem of arranging these guidelines into a hierarchy.

3.2.2. THE IMPOSSIBILITY OF AN ULTIMATE HIERARCHY OF FACTORS

The problem of hierarchy, as may already be apparent from the analysis above, is an extension of the inherent problems with determining source of income in general: that

[97] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 456.
[98] *CIR v Epstein* 1954 (3) SA 689 (A).
[99] L van Schalkwyk "Residence and Source" in M Stiglingh (ed) *Silke: South African Income Tax* (2013) 66.
[100] L van Schalkwyk "Residence and Source" in M Stiglingh (ed) *Silke: South African Income Tax* (2013) 67.

is, that it is impossible to lay down a precise test for its determination. In this way, the problem of hierarchy is not distinct from the inability to create a general test. For the sake of clarity, however, this problem will be evaluated separately. This analysis, therefore, provides a practical illustration of the problem outlined above by evaluating the frameworks that have been developed in South Africa and Hong Kong for the determination of source of income. This practical analysis will, furthermore, contribute to the understanding of both the source framework described in Chapter 2, and, importantly, the nature of the impossibility of a definitive test for determining source of income discussed in Section 3.2.1.

One of the key advances of the *Lever Brothers* judgment was the creation of a two-step framework according to which matters of source may be evaluated. As discussed in Chapter 2, this approach separates issues regarding source of income into two ostensibly factual questions: *what* is the originating cause of the income and *where* is it located. Although this two-step framework has been recognised[101] as the ultimate mechanism for the determination of source of income, under closer examination difficulties, which are not easily resolved, become apparent. These difficulties, it is suggested, have not become apparent in South African jurisprudence since they arose at the same time as the principle which provides their cure: the practical person. It is, therefore, useful to examine jurisprudence and commentary from Hong Kong where the development of their framework for determining source of income (the basic source principle) was not unequivocally in line with their adoption of the practical person principle.[102] This examination will reveal the second problem that the practical person principle operates to resolve.

[101] R Thackwell *The Contribution Made by Mr Justice EF Watermeyer to South African Tax Jurisprudence* (Unpublished Masters Thesis, Rhodes University 2010); L van Schalkwyk "Residence and Source" in M Stiglingh (ed) *Silke: South African Income Tax* (2013) 65; P Haupt *Notes on South African Income Tax* 32 ed (2013) 37.

[102] The difference between the South African approach and that in Hong Kong, is that in South Africa the two-step test arose together with the practical person principle. In the *Hang Seng Bank* [1990] UKPC 42 case it was never explicitly stated that the practical person principle was consistent with the Basic Source Principle. After *CIR v HK-TVB International Ltd* [1992] UKPC 21, there was even less certainty as to whether or not the practical person principle ought to play a role in the determination of source of income. Kuan argues that the approach of the judge in *TVBI* left no room for the practical person principle. (LH Kuan "Income Tax – Source Principle Refined" (1992) *Singapore Journal of Legal Studies* 566 at 577).

In Hong Kong, a basic framework against which issues of source may be examined was developed in two key cases: the *Hang Seng Bank*[103] case, and in *CIR v HK-TVB International Ltd* (*TVBI*).[104] In the *Hang Seng Bank* case, the Privy Council held that the broad guiding principle is to examine "what the taxpayer has done to earn the profits in question."[105] This approach, it is argued, is not dissimilar from the "activities test" articulated in *CIR v Epstein*[106] where it was held that "in taxing the respondent the Legislature looks at his activities and ascertains whether those activities were exercised within the Union."

This approach, termed the "Basic Source Principle," was quickly expanded upon in the subsequent *TVBI*[107] case, where it was held that "[t]he proper approach is to ascertain *what* were the operations which produced the relevant profits and *where* those operations took place" (emphasis added). This approach is strikingly similar to the two-step framework articulated by Watermeyer CJ in *Lever Brothers*. The *TVBI* approach is, however, nothing more than a nuanced version of the Basic Source Principle.[108] It is clear that the question of the *originating cause* of the income, Watermeyer CJ's first step, is analogous to the *activity* that gives rise to the income.[109] The second step of the test, that of locating the originating cause, while explicit in Watermeyer CJ's and *TVBI*'s formulations, is nevertheless implied in the Basic Source Principle. This is because it is necessary that the ultimate goal of any approach to finding source of income is locating that income. The Basic Source Principle, articulated in *Hang Seng Bank* and *TVBI* is, therefore, equivalent to the two-step framework established in *Lever Brothers*.[110] This similarity will allow conclusions drawn from the Basic Source Principle to be applied to the two-step framework.

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[103] *Hang Seng Bank* [1990] UKPC 42.
[104] *CIR v HK-TVB International Ltd* [1992] UKPC 21.
[105] *Hang Seng Bank* [1990] UKPC 42 51.
[106] *CIR v Epstein* 1954 (3) SA 689 (A) 699C.
[107] *CIR v HK-TVB International Ltd* [1992] UKPC 21 29.
[108] LH Kuan "Determining Sources of Income – A New Guiding Principle?" (1991) *Singapore Journal of Legal Studies* 517 at 521.
[109] LH Kuan "Determining Sources of Income – A New Guiding Principle?" (1991) *Singapore Journal of Legal Studies* 517 at 521.
[110] It may be noted that there are subtle differences between these two approaches: for example, the *TVBI* approach uses the term "operations" which has been criticised as being unduly vague and, therefore, offering little guidance, see LH Kuan "Income Tax – Source Principle Refined" (1992) *Singapore Journal of Legal Studies* 566 at 570. For the present purposes, however, such dissimilarities do not compromise the effectiveness of the analogy.

In analysing the Basic Source Principle, Kuan[111] identifies two problems that arise out of the *Hang Seng Bank* case. The first of these problems is that the Basic Source Principle does not provide guidance for determining the originating cause of income in cases where there are *multiple undertakings* by the taxpayer. For example, where a person owns fixed property in one country but spends a significant amount of energy abroad soliciting foreign tenants for that property. It is unclear which of these factors, the location of the property, or the work done to secure its occupation, ought to be seen as the originating source of the rental income. The Basic Source Principle does not create a hierarchy of factors in this regard and, therefore, is unequipped to deal with such situations.[112]

The second problem is that the Basic Source Principle does not clarify *where* the activities that give rise to the income in question take place.[113] It was this question that was in issue in the *Lever Brothers* case.[114] While it was accepted by all of the judges that the originating cause of the income was the granting of credit, the issue that remained was where such a cause ought to be located. The two-step framework does not provide clarity in this regard. Watermeyer CJ noted, echoing the problem outlined above, that he was not aware of any governing consideration for such a determination.[115] Instead, there will be in all cases a number of factors that must be weighed in order to come to a conclusion on the correct location of the income in question.

These two problems are essentially two sides of the same coin. That is, that the Basic Source Principle and the two-step framework provide useful guidelines for the manner in which source cases may be approached; however, they are not comprehensive tools for the determination of source of income in all cases. These approaches may, therefore, be seen as useful frameworks to direct a judge's analysis, but cannot be decisive on their own. It is, accordingly, inaccurate to describe the two-

[111] LH Kuan "Determining Sources of Income – A New Guiding Principle?" (1991) *Singapore Journal of Legal Studies* 517; LH Kuan "Income Tax – Source Principle Refined" (1992) *Singapore Journal of Legal Studies* 566.
[112] LH Kuan "Determining Sources of Income – A New Guiding Principle?" (1991) *Singapore Journal of Legal Studies* 517 at 521.
[113] LH Kuan "Determining Sources of Income – A New Guiding Principle?" (1991) *Singapore Journal of Legal Studies* 517 at 522.
[114] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 451.
[115] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 451.

step framework as a "test" as has been done by a number of authorities.[116]

These problems, however, do not necessarily arise in all cases.[117] It is only in difficult cases, where there are a *number of factors* to be considered, that these frameworks break down. In such cases, the guidelines provided by these frameworks are not sufficient on their own to provide a definitive answer to the question of source of income. This conclusion means that these frameworks are *limited* in their ability to locate source of income on their own.

The result of this analysis provides an important insight into the operation of the source of income inquiry. The recognition that these frameworks are not judicial tests, but are instead a kind of scaffolding, strikes at the heart of this issue. This is because, as held in both *Lever Brothers*[118] and *TVBI*,[119] the creation of an ultimate hierarchy of factors to overcome the limitations of these approaches is impossible. The reasoning given in these judgments is that the creation of such a hierarchy would give inadequate credence to the factual differences between cases and, therefore, would lead to unjust results. In other words, it was held that such a development would lead to the situation in which a strict application of the law would not have the requisite flexibility to adequately accommodate significant factual differences between cases.

It is worth noting again that this conclusion is supported in the case of *FNB v CIR*[120] where it was held that Watermeyer CJ in *Lever Brothers* did not intend to create a general rule for the treatment of interest income. Instead, this evaluation of the totality of the facts suggests that such a rule would not be appropriate.

This approach is, therefore, consistent with the reasoning in Section 3.2.1 above, that the creation of a universal test for determining source of income is impossible. This is because, if it were possible to create a hierarchy of factors for determining both the

[116] Davis AJA in *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 464; R Thackwell *The Contribution Made by Mr Justice EF Watermeyer to South African Tax Jurisprudence* (Unpublished Masters Thesis, Rhodes University 2010).
[117] LH Kuan "Determining Sources of Income – A New Guiding Principle?" (1991) *Singapore Journal of Legal Studies* 517 at 522.
[118] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 451.
[119] *CIR v HK-TVB International Ltd* [1992] UKPC 21.
[120] *FNB v CIR* 2002 (3) SA 357 (SCA) para 18.

origin and location of income, the result would be the development a comprehensive test for the determination of source of income. This would accordingly conflict with the intention of the Legislature and, from the recent analysis in Section 3.2.2, create a set of rules that would be unduly rigid.

The effect of this is that, while the framework within which each case ought to be decided remains constant, there can be no universal test that may be applied in all cases to determine the source of income. Even when ostensibly similar cases arise, such as the same type of income, there may be subtle factual differences that require different outcomes to be reached.

3.2.3. THE SOLUTION: THE ADOPTION OF THE PRACTICAL PERSON

From the discussion above, it is clear that an assessment of source of income presents a number of challenges. Firstly, the Legislature did not provide a definition for the term "source of income." Secondly, it was concluded that such a definition is impossible and that there can be no universal test for determining the source of income. Thirdly, the result of this was the creation of a framework for the determination of source of income, the intention of which was to provide some guidance to judges investigating source of income. Fourthly, this framework was not without difficulty, as it did not create an ultimate hierarchy of factors that would provide a conclusive test for the determination of source of income. Finally, the issue of hierarchy presents a more fundamental problem in that it was recognised that such a hierarchy would lead to an unjustly rigid application of the law in cases where factual differences required flexibility.

What was required, therefore, was a tool that would account for the need to ensure flexibility in all cases while at the same time fitting into the two-step framework, without compromising the Legislature's intention that a determination of source of income should not be subject to a universal test. The tool that was introduced to resolve all of these problems was the practical person principle.

3.3. DEFINING THE PRACTICAL PERSON

In South Africa, these problems went unnoticed, it is contended, largely because the development of the approach to questions of source of income included the use of the practical person principle as a tool to mediate them. It is this *comprehensive approach* that made the *Lever Brothers* decision a landmark case. Only by looking to other jurisdictions, where the practical person principle was not similarly accepted, do the above problems appear. What the *Lever Brothers* decision failed to do, however, was to offer a clear description of what is meant by the "practical person." This section, therefore, sets out to briefly define this concept as an important stepping-stone to the discussion of the operation of the practical person principle that follows.

The most notable description of the practical person in *Lever Brothers* comes from Davis AJA who states that

> the person whom Lord Atkin had in mind was the practical man *and not the legal theorist* who, by resolutely shutting his eyes to all the facts, could prove that black was white (emphasis added).[121]

From this description it is clear that the practical person is defined in contrast to the legal theorist. Support for this juxtaposition can be found in the *Nathan* decision where it was held that the source enquiry should be "not a legal concept, but something which the practical man would regard as a real source of income."[122] Again, the practical person is intended to facilitate reasoning that is not legalistic.

The *Nathan* case continues to state that the source enquiry must be "a practical hard matter of fact."[123] This statement gives content to the role that the practical person is intended to fulfill. Specifically it indicates that the practical person is a mechanism that has two key functions. This mechanism will be referred to as the "*Nathan* maxim."

The first of these functions is to ensure that the enquiry is practical. Practicality, although not defined in the case, is submitted to be concerned with the actual or real

[121] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 465.
[122] *Nathan v FCT* (1918) 25 CLR 183 186.
[123] *Nathan v FCT* (1918) 25 CLR 183.

state of affairs and not, as Davis AJA indicates above, theoretical or philosophical ponderings. The practical person is, therefore, exemplified by common sense rather than the "hair splitting" associated with technical legal rules.[124]

In short, the practical person is pragmatic. The use of the practical person principle is, therefore, designed to ensure that judges adopt the same pragmatism in their approach to issues of source of income. They must, in other words, determine source of income as the hypothetical practical person would.

The second function of the practical person principle is to place emphasis on the particular facts of each case. Although this is a necessary aspect of judicial decision-making, it is argued that the practical person principle requires that judicial precedent should be accorded less importance than would ordinarily be the case. This is in order to make room for a kind of factual-precedence. The practical person principle is, therefore, a tool that is used to ensure a *case-by-case treatment* of matters regarding source of income.

The role of the practical person can, therefore, be seen as an anthropomorphisation of the underlying judicial principles of the *Nathan* maxim. In this way, it is similar to the concept of the reasonable person from criminal law[125] and the law of delict, which is also personified.

The reasonable person, it is reasoned, was introduced to fulfil a similar role to that of the practical person. This is demonstrated in the case of *R v Smith (Morgan)*[126] where it was held that

> [T]he concept of the 'reasonable man' has never been more than a way of explaining the law to a jury; an *anthropomorphic image to convey to them, with a suitable degree of vividness, the legal principle* that… people must conform to an objective standard of behaviour that society is entitled to expect (emphasis added).

[124] B Russell *The Problems of Philosophy* (1959); AJ Halkyard "Hong Kong Profits Tax: The Source Concept: Part 1" (1990) 20(2) *Hong Kong Law Journal* 232 at 242.
[125] V Nourse "After the Reasonable Man: Getting over the Subjectivity/Objectivity Question" (2008) 11(1) *New Criminal Law Review* 33 at 34.
[126] *R v Smith (Morgan)* [2001] 1 AC 146 172 E - F.

Nourse, however, argues that anthropomorphising the reasonable person "does more to obscure than reveal."[127] In this regard she contends that the image conveyed by the anthropomorphised depiction brings with it more than just the legal principles behind it. In other words, it allows judges to introduce their own conceptions of the characteristics of the practical person into the judicial decision-making process. There is, furthermore, evidence of this happening in *Lever Brothers*. Firstly, Schreiner JA held that the person, whose hypothetical views must be considered, is the "practical business man."[128] This suggests someone with a degree of education as well as business acumen, perhaps even a professional of some kind. Clearly the views of the practical businessperson are different to those of the practical person and, therefore, Schreiner JA's consideration ought to change accordingly.

Secondly, both Watermeyer CJ[129] and Schreiner JA[130] indicated that the views of the practical person would, in effect, align with the views of a lawyer. In this regard they seem to be imputing abilities on the practical person that Davis AJA does not. The consequence of this is that the reasoning used by the judges will necessarily differ since they are deferring to different conceptions of the practical person. The anthropomorphisation of the practical person, therefore, allows judges to bring their own notions of the concept into the judgment and, essentially, allows the case to be judged by differing standards.

The practical person, in conclusion, is a tool that must be used to ensure that source of income is correctly located. In this regard it is an anthropomorphisation of two underlying principles: the importance of practicality and an emphasis on the specific facts of the case. The sum of these, as held by Davis AJA, is to create an approach that is practical and not philosophical in nature. As with all anthropomorphisations, however, it is shown that the image of the practical person creates the leeway to introduce further considerations into the judicial decision-making process. This is evident from the discordance illustrated between the judges in *Lever Brothers*. The practical person principle is, therefore, no more than a vague approximation of the

[127] V Nourse "After the Reasonable Man: Getting over the Subjectivity/Objectivity Question" (2008) 11(1) *New Criminal Law Review* 33 at 34-35.
[128] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 463.
[129] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 457.
[130] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 463.

legal principles at the heart of the source enquiry. This vagueness, furthermore, permits more than just these principles forming part of the judicial making process.

3.4. THE OPERATION OF THE PRACTICAL PERSON PRINCIPLE

In the *Nathan* decision it was held that the practical person principle should be used to achieve two things.[131] First, it must give adequate credence to the factual matrix of each case and, second, it should be used to arrive at conclusions practically and not formalistically. These legal principles, embodied in the practical person principle, operate to overcome the problems with the source enquiry in general as well as the problems with the two-step framework in particular. This is achieved through the interplay between six key characteristics of the practical person principle. Each of these aspects will be discussed in turn below.

3.4.1. THE PRACTICAL PERSON AS AN ATTITUDE OF MIND

The first aspect of the operation of the practical person principle is that the two principles embodied in the *Nathan* maxim provide a mechanism that informs the application of Watermeyer CJ's two-step framework in *Lever Brothers*. In this regard, Balazs comments that

> Practical reality is not a test so much as an *attitude of mind* in which the Court should approach the task of judgment. Reality, like beauty, is often in the eye of the beholder" (emphasis added).[132]

In a sense the practical person principle, therefore, provides a *lens of practicality* through which the ordinary legal framework must be viewed.[133]

In sum, this "lens of practicality" enables the *comprehensive approach* of the two-step framework informed by the *Nathan* maxim, and is the crux of Watermeyer CJ's

[131] *Nathan v FCT* (1918) 25 CLR 183.
[132] *Nathan v FCT* (1918) 25 CLR 183.
[133] Kuan 1991 *Singapore Journal of Legal Studies* 520, where it is argued that the legal framework must be seen "through the eyes of the practical man." Also see J Balazs "An Introduction to Australia's Tax System: How Source is Determined" (2009) 7 http://www.blwllp.com/getattachment/a00ed84b-b7b8-429a-b39f-2e875a91e6a6/How-is-Source-Determined--.aspx (accessed 8 May 2013) at 7, where it is argued that "practical reality is not a test so much as an attitude of mind in which the Court should approach the task of judgment."

contribution in *Lever Brothers* (his *ratio decidendi*). It has become the authoritative model for determining source of income in South Africa and has been referred to with approval on numerous occasions.[134] The effect of this comprehensive approach is to prescribe a method for determining the source of income that gives judges the structure of the two-step framework, while at the same time granting them the freedom associated with the practical person principle to decide the cases practically and factually.

3.4.2. THE WEIGHT OF THE PRACTICAL PERSON PRINCIPLE

The second aspect of the practical person principle is that it is to be accorded *sufficient weight* in the judicial decision-making process. In other words, the principle should be given sufficient influence over the outcome of a judgment to ensure that the problems discussed in Section 3.2 do not arise.

Although the weight to be placed on the practical person principle in the judicial decision-making process is not decisively stated in *Lever Brothers*, there are a number of statements that point toward an answer. The most forthright of these is the statement by Davis AJA[135] in which the practical person principle is described as a "test" that the court is "bound to adopt." If this interpretation is followed, the use of the practical person principle is mandatory and must be accorded significant weight in coming to a conclusion. Schreiner JA undertakes a similar approach when it is stated that the views of the practical person are "entitled to great weight."[136]

The least prescriptive of the judges in *Lever Brothers* is Watermeyer CJ who refers to the practical person principle as a suggestion.[137] This seemingly indicates that it does not need to be considered. It would appear, therefore, that there is no unanimous conclusion to this question in *Lever Brothers*.

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[134] Including: *CIR v Epstein* 1954 (3) SA 689 (A); *CIR v Black* 1957 (3) SA 536 (A); *COT v British United Shoe Machinery* (SA) (Pty) Ltd 1964 (3) SA 193 (FC); *COT v R* 1966 (2) SA 342 (RA); *Tuck v CIR* 1988 (3) SA 819 (A); *Essential Sterolin Products (Pty) Ltd v CIR* 1993 (4) SA 859 (A).
[135] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 464.
[136] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 463.
[137] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 457.

Assistance can be gained, however, from the *Nathan* case, in which it was held that the word "source" was intended by the Legislature to be "something which a practical man would regard as a real source of income."[138] This statement indicates that the Legislature intended something akin to the practical person principle to form a crucial part of the source of income enquiry. Over and above this, as discussed in Section 3.2.1, it indicates that the intention of the Legislature was that the core of the source of income enquiry should be practical in nature. It follows, therefore, that the use of the practical person principle is not only anticipated by the Legislature, but it is also intended by it to be an important criterion for its location.

The description above seems to accord with the scheme of Watermeyer CJ's judgment in *Lever Brothers*. This approach is to use the practical person as a tool to assess each stage of the two-step framework. If this were not intended to be the case, it would have been unnecessary to consider the views of the practical person in his concluding remarks.[139] This is especially significant since it is proposed that the practical person would come to the same conclusion as the one that had already been determined. Such deference to the practical person would have, therefore, been redundant had Watermeyer CJ not found it *necessary* to come to a conclusion based on the views of the hypothetical practical person.

Given the scheme of Watermeyer CJ's judgment, the agreement between Schreiner JA and Davis AJA, and the conclusions in *Nathan*, it necessarily follows that the practical person principle is a mandatory consideration. Furthermore, it would be nonsensical to require the evaluation of a concept that is not intended to contribute to a final decision. The practical person principle must, therefore, be accorded significant weight in determining source of income.

3.4.3. SUBSTANCE IS GIVEN PRECEDENCE OVER FORM

The third aspect of the practical person principle is that it requires the court to "look at the real substance of the transaction and not the technicalities and embroideries

[138] J Balazs "An Introduction to Australia's Tax System: How Source is Determined" (2009) 7 http://www.blwllp.com/getattachment/a00ed84b-b7b8-429a-b39f-2e875a91e6a6/How-is-Source-Determined--.aspx (accessed 8 May 2013).
[139] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 457.

surrounding it."[140] While this principle is an important characteristic of tax law in general,[141] it is also a necessary result of the *Nathan* maxim. This is because of the great emphasis placed on the true facts of each case. Liang[142] argues further that the source of income enquiry needs to be able to look at the true nature of a tax avoidance scheme. The practical person principle, therefore, gives the court the right to look past the form of a transaction and assess the matter on its substance.

Despite this, Wills[143] notes that Australian courts have tended to break away from the hard matter-of-fact approach. The result is a focus "on the formalities of the transaction concerned, rather than on where the economic activity which gave rise to the income occurred."[144] While this has been the lived experience of cases involving source of income in Australia, it is maintained that this is not a reflection of the true operation of the practical person principle. Wills makes it clear that this new approach is removed from the original ambit of the *Nathan* maxim[145] and, therefore, by implication, the practical person principle.

In order to give precedence to the substance of a matter over its form, it was held in *FCT v United Aircraft Corporation*[146] that a case-by-case approach is sanctioned. In this regard it was held that "screens, pretexts, devices and other unrealities" should not get in the way of the court assessing the true nature of the facts at hand, and that "a decision on one set of facts is not binding and is often of little help on another set

[140] LH Kuan "Determining Sources of Income – A New Guiding Principle?" (1991) *Singapore Journal of Legal Studies* 517 at 520.
[141] *Dadoo Ltd v Krugersdorp Municipal Council* 1920 AD 530; *Duke of Westminster v IRC* [1936] AC 1. See also TL Weston *A Comparison of the Effectiveness of the Judicial Doctrine of "Substance Over Form" with Legislated Measures in Combatting Tax Avoidance* (Masters Thesis, Rhodes University 2004).
[142] TW Liang "The Source of Interest: Section 10 and Section 12(6) of the Income Tax Act" (1988) 30 *Malaya Law Review* 393 at 399.
[143] M Wills "The Income Tax Implications of a Foreign Individual Contracting to do Business in Australia, with Particular Reference to Concepts of 'Residence' and 'Source'" (1997) 9(1) *Bond Law Review* 34 at 46.
[144] M Wills "The Income Tax Implications of a Foreign Individual Contracting to do Business in Australia, with Particular Reference to Concepts of 'Residence' and 'Source'" (1997) 9(1) *Bond Law Review* 34 at 46.
[145] M Wills "The Income Tax Implications of a Foreign Individual Contracting to do Business in Australia, with Particular Reference to Concepts of 'Residence' and 'Source'" (1997) 9(1) *Bond Law Review* 34 at 46.
[146] *FCT v United Aircraft Corporation* (1943) 68 CLR 525 538.

of facts."[147] The effect of this is that every case must be decided on the basis of its own circumstances with an emphasis on its particular "hard facts."

3.4.4. TECHNICAL INTERPRETATION OF LEGAL RULES SET ASIDE

The fourth aspect of the practical person principle, as noted indirectly by Davis AJA in *Lever Brothers*[148] is that it operates to prevent an unnecessarily artificial application of the law. This characteristic is succinctly summarised by Balazs as follows:

> What the cases require is that the truth of the matter be sought with an eye focused on practical business affairs, rather than on nice distinctions of the law. For the word "source", in this context, has *no precise or technical reference*. It expresses only a general conception of origin, leading the mind broadly, by analogy. The true meaning of the word evokes springs in grottos at Delphi, sooner than the incidence of taxes. So *the exactness which the lawyer is prone to seek must be consciously set aside*; indeed, with respect to a choice between various contributing factors, it cannot be attained (emphasis added).[149]

A similar sentiment can be found in the judgment of Schreiner JA in *Lever Brothers*[150] where the importance of defining terms according to "ordinary linguistic usage" is stressed. What these two tools share, therefore, is the ability to look past a dogmatic adherence to established legal rules in cases where the application of such rules would lead to unjust results.

Support for this conclusion can be found in *FCT v Mitchum*[151] where it was held, referring to questions of source of income, that "there are no presumptions and no rules of law which require that that question be resolved in any particular sense." This is, accordingly, a recognition that the role of judicial precedent in cases involving source of income may operate to unduly constrict the outcome of the case. This was confirmed in *FCT v Efstathakis*[152] where it was held that "the answer is not to be

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[147] *FCT v United Aircraft Corporation* (1943) 68 CLR 525 538.
[148] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 465.
[149] J Balazs "An Introduction to Australia's Tax System: How Source is Determined" (2009) 7 http://www.blwllp.com/getattachment/a00ed84b-b7b8-429a-b39f-2e875a91e6a6/How-is-Source-Determined--.aspx (accessed 8 May 2013).
[150] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 458.
[151] *FCT v Mitchum* (1965) 39 ALJR 23 26.
[152] *FCT v Efstathakis* (1979) ATC 4256 4259.

found in the cases, but in the weighing of the various factors which the cases have shown to be relevant."

These cases are, therefore, in line with the discussion in Section 3.4.3, which concluded that matters should be decided on a case-by-case basis. They, accordingly, lend support for the proposition that the role of judicial precedent is diminished in cases involving source of income.

The remarks above are strikingly similar to those made by Nourse[153] regarding the underlying application of the reasonable person in criminal law. She describes this concept as operating to guard against the overzealous application of legal doctrine to issues that are heavily contingent on the factual matrix of a specific case.[154] In a similar way, the practical person principle can be seen as a tool that facilitates a departure from the strict application of legal rules and judicial precedent, to ensure that the facts of each case are considered in such a way that it achieves a just result. The practical person principle accomplishes this by removing the emphasis from strict formalism and placing it on practical reality.

3.4.5. A FLEXIBLE CRITERION

The fifth aspect of the practical person principle is that it operates to provide an exceptionally flexible criterion for the assessment of source of income cases. This is as a result of a number of intersecting factors. In the first place, the role of judicial precedent and the strict application of established legal norms are intentionally diminished. This provides, in the second instance, room for a case-by-case analysis. The emphasis of this analysis, in the third instance, is on the specific facts of the case through the lens of the practical person.

The combination of these factors is vital for the source of income enquiry as it grants the necessary *flexibility* to overcome the two problems outlined in Section 3.2. The first problem, that there cannot be a universal test for determining source of income,

[153] V Nourse "After the Reasonable Man: Getting over the Subjectivity/Objectivity Question" (2008) 11(1) *New Criminal Law Review* 33.
[154] V Nourse "After the Reasonable Man: Getting over the Subjectivity/Objectivity Question" (2008) 11(1) *New Criminal Law Review* 33 at 38.

is overcome by the operation of the practical person principle by placing a great deal of emphasis on the peculiar facts of each case. In this way, a comprehensive approach (the two-step framework coupled with the *Nathan* maxim) is created without producing a *universal test* that will apply in all cases.[155] In fact, this approach is so flexible that it actively prohibits the creation of rules that will apply to future source of income cases.

The second problem, that there cannot be an ultimate hierarchy of factors for determining source of income, is similarly overcome by the flexible practical person principle. Allowing cases to be decided according to practical reality, and by emphasising the substance-over-form of the transactions in question, leads to the situation in which competing factors can be weighed without establishing a permanent hierarchy. Again, this is supported by the emphasis on factual-precedence over judicial precedence.

It is, therefore, clear that the operation of the practical person is *necessarily* flexible in nature. Consequentially, the crux of Watermeyer CJ's contribution in *Lever Brothers* was the creation of a broad framework for the analysis of source of income complemented by the malleable practical person principle. This comprehensive approach operates to guide the method taken in future cases without hampering the judge's ability to come to a conclusion based on the practical reality of the case at hand. In order to operate effectively, however, this guide must provide the necessary flexibility to overcome the problems outlined above. The result of this is an exceptionally flexible criterion for the decision of cases concerning source of income.

3.4.6. ALIGN THE LAW WITH PUBLIC PERCEPTIONS

The final aspect of the operation of the practical person principle is one that was not necessarily intended by the authorities that established the source framework; however, it is suggested that it is of growing importance given the advent of constitutionalism in South Africa. That is, that the practical person principle provides a useful mechanism to align the law with public perceptions of it.

[155] M Wills "The Income Tax Implications of a Foreign Individual Contracting to do Business in Australia, with Particular Reference to Concepts of 'Residence' and 'Source'" (1997) 9(1) *Bond Law Review* 34 at 46.

Devenish[156] argues that the implementation of the interim Constitution[157] brought with it an extension of the values of the community (*boni mores*) to all forms of law. The effect of this is to transport South Africa from a culture of authority to one of justification[158] with the result that the laws of the country should broadly reflect the views of our heterogeneous community.[159] Support for this can be found in the preamble to the Constitution[160] which begins with the statement "we the people" signifying that it has the support of the nation as a whole. Since all law must be consistent with the Constitution,[161] the implication is that all law should be supported by "the people" as far as reasonably possible.

The practical person principle, in its deference to the views of the ordinary people of the country, therefore, provides a mechanism that may potentially be used by judges to ensure that the outcome of each case is in line with the views of the South African community. It is argued that this is an important goal in a society that seems to value the creation of exceptionally complex pieces of legislation in spite the reality of pervasive illiteracy.

3.5. CONCLUSION

The *Lever Brothers* case is a landmark decision in South Africa's tax jurisprudence as it introduced the comprehensive approach for determining source of income. This approach has since been approved on numerous occasions and has become the authoritative position for determining source of income in South Africa.

The key to the success of the comprehensive approach is its ability to prescribe a method for finding source of income that gives judges the structure of the two-step framework, while at the same time granting them the freedom associated with the practical person principle to decide the cases practically and factually. In this way, the comprehensive approach effectively overcomes the problems inherent in the source enquiry in general as well as with the two-step framework in particular. It manages to

[156] GE Devenish *The South African Constitution* (2005) 23.
[157] The Constitution of the Republic of South Arica Act 200 of 1993.
[158] GE Devenish *The South African Constitution* (2005) 23.
[159] GE Devenish *The South African Constitution* (2005) 23.
[160] The Constitution of the Republic of South Africa, 1996.
[161] Section 1 of the Constitution of the Republic of South Africa, 1996.

give guidance to judges without prescribing a universal test or creating an ultimate hierarchy.

At the core of the comprehensive approach is the *Nathan* maxim, which requires an emphasis on practical reality and the hard facts of the case. These principles are personified in the form of the practical person, which provides a mechanism to come to conclusions on the basis of practicality rather than philosophy.

The practical person principle, consequentially, provides judges with a lens through which the two-step framework must be seen. With sufficient weight on this so-called attitude of mind, judges are able to give effect to the true substance of a matter and ignore technical legal rules that would otherwise lead to unjust results. At the heart of the practical person principle is, therefore, a flexible criterion that allows judges to decide cases according to practical reality. If used correctly this tool may also enhance the ability of judges to align the law with public perceptions of it and, correspondingly, enhance the legitimacy of the law.

CHAPTER 4: CRITIQUE OF THE PRACTICAL PERSON

> *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*
> – Watermeyer CJ, *Lever Brothers*

4.1. INTRODUCTION

The practical person principle outlined in Chapter 3 provides an elegant solution to the problems inherent to the source of income inquiry. The introduction of this principle as a tool for deciding such cases was, therefore, a fitting strategy adopted in the cases following *Nathan* and culminating in the comprehensive approach adopted in *Lever Brothers*. The striking feature of *Lever Brothers*, however, is that each of the judges was able to use the practical person principle to come to a completely different conclusion. This judicial discord, while not necessarily problematic in and of itself, is possibly an indication of a deeper concern with the tools used in the judicial decision-making process.

This chapter will critically analyse the precedent set down in *Lever Brothers* and argue that, instead of creating a framework that is worthy of the praise it has received, the judges entrenched a flawed concept that actively undermines several central aspects of our justice system: the doctrine of judicial precedent, prospective application of the law, legal certainty, legality and the rule of law.

This critique will be carried out on two levels. First, the problems with the practical person in *practice* will be discussed. These problems are particular to the way the practical person principle was used in *Lever Brothers*: that it is inadequately defined and that it improperly combines analytically separate enquiries. These problems may, therefore, be overcome by recasting the practical person principle in a different mould. It will be argued that the approach suggested by Nourse provides a suitable solution to these problems by looking to the underlying operation of the principle and

by describing a new conception of the principle that is based on its true operation rather than on the visage of the practical person.

The second level of critique will look at the problems with the practical approach in *principle*. These problems arise out of the broad approach to source of income and are, therefore, independent of the guise that the practical person is given. They can, thus, be attributed to an application of the principles that underlie the practical person, first that the practical person is incapable of dealing with complex legal issues and, second, that its inherent flexibility leaves room to its manipulation by judges, both consciously and subconsciously.

It is this second critique of the practical person principle that illustrates its predisposition to cause the problems listed above. These "down-stream effects" of the underlying principles are then briefly discussed in order to illustrate the severity of the problem it presents.

4.2. PROBLEMS IN PRACTICE

The first set of problems with the practical person principle arises out of the way the principle has been used traditionally and in particular in the *Lever Brothers* judgment. These are, therefore, problems with the manner in which the principle is described and may be overcome by re-describing the principle.[162] This section will set out two key problems with the principle as it has been used. First, that the practical person principle does not provide an adequate description of the characteristics of the personified standard that ought to be used, and second, that it over-burdens the metaphor by combining separate enquiries. Both of these problems, therefore, arise out of the act of anthropomorphising the principle. Nourse, analysing the similar concept of the "reasonable person" from criminal law, argues that these problems if "conceived differently, might disappear."[163]

[162] V Nourse "After the Reasonable Man: Getting over the Subjectivity/Objectivity Question" (2008) 11(1) *New Criminal Law Review* 33 at 36.
[163] V Nourse "After the Reasonable Man: Getting over the Subjectivity/Objectivity Question" (2008) 11(1) *New Criminal Law Review* 33 at 36.

4.2.1. PROBLEM OF INADEQUATE DESCRIPTION

The first problem with an anthropomorphised practical person is the question of identity. Who is the practical person? In Section 3.3 it is concluded that the *Lever Brothers* judgment failed to give a clear description of the practical person and that the anthropomorphised figure is used as a vague approximation of the underlying legal principles described in the *Nathan* maxim. The practical person is, accordingly, the embodiment of the principles required by the source of income enquiry. In this way, the practical person is similar to the reasonable person. They are both used to convey the appropriate standard by which a case should be decided to the judge.[164] The problem with this, as Nourse[165] illustrates, is that image conveyed by the anthropomorphised practical person brings with it more than just the legal principles behind it. It allows judges to introduce their own conceptions of the characteristics of the practical person into the decision-making process.

In order to remove the vagueness associated with the practical person personification, the concept must, therefore, be defined more exactly. This would have the effect of circumscribing the standard that judges should apply to the decision-making process. The more accurately the standard can be demarcated, the less latitude there will be for the concept to be misused through the judge's own ideas of practicality. In this regard, Nourse asks, for example, whether this concept should take account of characteristics such as age, sex or culture,[166] or whether it should be seen as a "*statistical norm* of the average or ideal or something else entirely (emphasis added)."[167]

In *R v Camplin*,[168] the court, also discussing the reasonable person, importantly concluded that it is the "ordinary person." It is a description of how ordinary people are expected by their fellow citizens to act in society.[169] The problem with this, however, is determining who the ordinary person is. For the present purposes, what practicality can be considered ordinary? This is important because differences

[164] *R v Smith (Morgan)* [2001] 1 AC 146 172 E - F.
[165] V Nourse "After the Reasonable Man: Getting over the Subjectivity/Objectivity Question" (2008) 11(1) *New Criminal Law Review* 33 at 40.
[166] V Nourse "After the Reasonable Man: Getting over the Subjectivity/Objectivity Question" (2008) 11(1) *New Criminal Law Review* 33 at 35.
[167] V Nourse "After the Reasonable Man: Getting over the Subjectivity/Objectivity Question" (2008) 11(1) *New Criminal Law Review* 33 at 40.
[168] *R v Camplin* 1978 AC 705.
[169] *R v Camplin* 1978 AC 705.

between people on the basis of sex, gender, race, ethnicity, culture, age etc. cannot, it is advocated, be averaged out. This is the case for two reasons: first, that historical differences between people cannot simply be forgotten as to do so would be to neglect the distorting effect of centuries of discrimination. South Africa has also made a commitment in section 9(2) of the Constitution to correct the effects of historical discrimination. Second, South Africa has also made a constitutional commitment to recognise and protect legitimate differences between people.[170]

Any attempt to homologise the differences implicit in a heterogeneous society will, therefore, fail to properly account for both the effects of institutionalised discrimination as well as important cultural differences.[171] The effect of this is that the "ordinary man" sought by *R v Camplin*[172] cannot account for the varied societal expectations of what it means to be practical. In other words, how society expects people to react to a situation may differ widely from group to group. Similarly, for the present case, the standard of practicality will vary across society.

The problem of description can, therefore, be summed up as a tension between the general and the specific: on the one hand, the personified practical person cannot give judges too much room to impute their own conceptions of practicality onto the matter, as to do so would render the standard unduly vague.[173] On the other hand, however, the notion of *an* "ordinary person" is illusory; this is because the more particularly the standard is defined, the less meaningful its application becomes in a heterogeneous society. Essentially, the only way for the practical person to have any value is for it to be decidedly unrepresentative or undemocratic. The personified practical person, therefore, finds itself truly torn between "Scylla and Charybdis."

[170] Section 9 of The Constitution of the Republic of South Africa, 1996; GE Devenish *The South African Constitution* (2005) 18.
[171] GE Devenish *The South African Constitution* (2005) 18-19.
[172] *R v Camplin* 1978 AC 705.
[173] This is something that Watermeyer CJ and Schreiner JA seem confortable with since they both equate their conclusions with those of the practical person.

4.2.2. PROBLEM OF CONFLATING SEPARATE INQUIRIES

The second problem with the anthropomorphised practical person is that combines "analytically separate enquiries."[174] Nourse, writing with reference to the concept of the reasonable person, argues that the use of this tool as a standard for judgment creates theoretical tensions in the way it balances subjective and objective approaches to a criminal case. The reasonable person sets out to achieve, according to Nourse, a method of giving adequate credence to a person's subjective state of affairs when applying an objective framework of rules.

This is summed up in the case of *R v Smith (Morgan)*[175] as follows:

> [the reasonable person is] a way of explaining the law to a jury; an anthropomorphic image to convey to them, with suitable degree of vividness, the legal principle that even under provocation, people must conform to an objective standard of behaviour that society is entitled to expect.

The problem is essentially that, in criminal cases for example, the person on trial must be tried according to their own characteristics. In other words there must be a *subjective* approach. This approach would, however, lead to injustices where it is applied too strictly. As Nourse notes "the defendant's norms will acquit him."[176] This requires an *objective* approach. An overly objective approach on the other hand may be similarly unjust since important factors such as the defendant's age, mental capacity and physical characteristics, as examples, will be disregarded.[177] Many countries have, therefore, adopted a *hybrid approach*: one that treats defendants subjectively but then also requires that they comply with a certain standard expected by society. This standard is that of the reasonable person.[178]

The hybrid approach, however, is not without difficulty; it has been described as creating a tension that appears to unite opposite theoretical approaches. In this regard

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[174] V Nourse "After the Reasonable Man: Getting over the Subjectivity/Objectivity Question" (2008) 11(1) *New Criminal Law Review* 33 at 38.
[175] *R v Smith (Morgan)* [2001] 1 AC 146 172 E - F.
[176] V Nourse "After the Reasonable Man: Getting over the Subjectivity/Objectivity Question" (2008) 11(1) *New Criminal Law Review* 33 at 36.
[177] V Nourse "After the Reasonable Man: Getting over the Subjectivity/Objectivity Question" (2008) 11(1) *New Criminal Law Review* 33.
[178] Alternatively termed in various legal areas: the layperson, prudent person or *bonus pater familias* (the good family father).

it requires that cases be judged objectively, implying strict adherence to the *rules*, as well as subjectively, allowing important *flexibility*. In another sense, the hybrid approach can be seen as blurring the distinction between *facts* and *norms*: objectivity requires an abstract application of norms while subjectivity requires that the factual context be given priority.[179]

The application of the reasonable person has the effect, according to Nourse,[180] of hiding these tensions by conflating these separate enquiries. The result of this is that we are forced to "whipsaw between hypermajoritarian views (the [objective] standard of the law-abiding) and hyperminoritarian views (the [subjective] standard of the particular defendant)."[181]

It is contended that similar tensions between facts and norms arise out of the use of the practical person principle in source of income cases: there are legal concepts that must be applied but, the court in the *Nathan* case was aware that if a prescriptive body of law were to develop, this would lead to unjust results.[182] The practical person principle as set out in Section 3.2, therefore, operates to allow a practical approach to the facts of each case.

The problem with this, however, lies in the personification of these underlying principles. By conflating these principles into a single enquiry, the true operation of the practical person is lost. The effect of this is illustrated in the *Lever Brothers* case. Both Watermeyer CJ and Schreiner JA adopt majoritarian (objective) approaches to determining the source of income. In other words, they both use legal reasoning to come to a preliminary conclusion and then justify this conclusion with reference to the practical person. It is argued, that this use of the practical person principle, as an after-the-fact justification for a conclusion that has already been arrived at, is a misunderstanding of the tool's purpose to mediate the tension between fact and law.

[179] V Nourse "After the Reasonable Man: Getting over the Subjectivity/Objectivity Question" (2008) 11(1) *New Criminal Law Review* 33 at 36.
[180] V Nourse "After the Reasonable Man: Getting over the Subjectivity/Objectivity Question" (2008) 11(1) *New Criminal Law Review* 33 at 38.
[181] V Nourse "After the Reasonable Man: Getting over the Subjectivity/Objectivity Question" (2008) 11(1) *New Criminal Law Review* 33 at 48.
[182] J Balazs "An Introduction to Australia's Tax System: How Source is Determined" (2009) 7 http://www.blwllp.com/getattachment/a00ed84b-b7b8-429a-b39f-2e875a91e6a6/How-is-Source-Determined--.aspx (accessed 8 May 2013).

In other words, it ought to operate to achieve a decision that is supported objectively in law without being disconnected from the subjective reality of the particular facts of the case.

The judgment of Davis AJA on the other hand illustrates the "whipsaw" tendency of such anthropomorphisations by allowing him to take the polar opposite approach to the facts in *Lever Brothers*. Davis AJA predicated his decision entirely on the application of the practical person principle to the facts of the case. In this way, the judgment is devoid of any reference to objective norms. Again, approaching questions of source of income from a purely a fact-based, subjective point of view fails to accommodate the full application of the practical person principle.

4.2.3. SOLUTION: REFLECT AND RESTRAIN

The solution to the problems outlined in Sections 4.2.1 and 4.2.2 argues Nourse,[183] is to conceive the anthropomorphic image differently. She argues that it is not the nature of the inquiry that causes these tensions but rather it is its form. By looking to the underlying operation of the reasonable person principle, Nourse devises a way to disentangle the separate enquiries, and creates a two-step structured process.[184]

The heart of the personified concept, Nourse argues, is that the reasonable person is a tool for preventing legal norms from being applied too strictly to a particular case. What it sets out to achieve, therefore, is an effective way of *reflecting* the law as it stands and then *restraining* its overzealous application by requiring that the factual matrix be considered.[185] This structured approach, it is contended, captures the similar operation of the practical person principle in source of income cases. In such cases, there are legal concepts that must be applied; however, the court in *Nathan,* it is reasoned, was aware that if a prescriptive body of law were to develop, this would

[183] V Nourse "After the Reasonable Man: Getting over the Subjectivity/Objectivity Question" (2008) 11(1) *New Criminal Law Review* 33 at 38.
[184] V Nourse "After the Reasonable Man: Getting over the Subjectivity/Objectivity Question" (2008) 11(1) *New Criminal Law Review* 33 at 41.
[185] V Nourse "After the Reasonable Man: Getting over the Subjectivity/Objectivity Question" (2008) 11(1) *New Criminal Law Review* 33 at 38.

lead to unjust results.[186] The solution developed in *Nathan* and implemented in *Lever Brothers* was to use the practical person concept as a mechanism to restrain the law when its application to a particular set of facts would lead to unjust results. As shown in Section 3.4 the practical person principle facilitates a departure from the strict application of legal rules and judicial precedent to ensure that a just result is achieved.

By looking to the true operation of the practical person as a tool to reflect and restrain the application of the law to a particular case, it is argued that the problems outlined in Sections 4.2.1 and 4.2.2 disappear. This is because the enquiry is no longer predicated on an anthropomorphised standard. In the first instance it does not require that judges decide cases with reference to the views of any particular person or group of people. This means that the task of judging matters of source of income is no longer prone to the problems of overly general or overly specific descriptions of the standard of practicality.

In the second instance, the two-step structured approach provided by Nourse,[187] avoids overburdening the metaphor of the practical person by separating the inquiries to be undertaken. The effect of this is to mediate the tendency to adopt approaches to determining the source of income that are either overly objective or overly subjective. Instead, it requires that all cases proceed from a legal foundation and then, where this would lead to unjust results, restrain the strict operation of the law. The method for achieving such restraint is through deference to practicality and the hard facts of the specific case at hand. Essentially by using the un-personified principles of the *Nathan* maxim.

If this approach were adopted in the *Lever Brothers* case, it would have prevented the judges from proceeding from radically different assumptions of the role of the practical person. In this regard, all of the judges made a mistake in their applications of the concept. Davis AJA was incorrect to neglect an analysis of the normative framework, while Watermeyer CJ and Schreiner JA were incorrect to justify their

[186] J Balazs "An Introduction to Australia's Tax System: How Source is Determined" (2009) 7 http://www.blwllp.com/getattachment/a00ed84b-b7b8-429a-b39f-2e875a91e6a6/How-is-Source-Determined--.aspx (accessed 8 May 2013).
[187] V Nourse "After the Reasonable Man: Getting over the Subjectivity/Objectivity Question" (2008) 11(1) *New Criminal Law Review* 33 at 50.

conclusions with reference to the practical person. Instead, the correct approach would have entailed applying the law to the facts of the case and then asking whether this application had the effect of creating an unjust outcome. If the outcome were unjust, the judges would be permitted to restrain the application of the law to the facts.

This approach provides judges with a framework with which to decide cases that does not require an evaluation of the characteristics of a personified practical person. At the same time, it allows the flexibility required to ensure that a prescriptive body of law does not develop. This effectively prevents the overzealous application of established rules to cases where the result would be unduly harsh or unjust. The tenets of the *Nathan* maxim – practicality and factual-precedence – are, therefore, protected by the reflect and restrain approach while at the same time the problems that arise out of its personification are avoided.

4.3. PROBLEMS IN PRINCIPLE

It has been shown that removing the anthropomorphic visage from the judicial approach to determining source of income overcomes the problems set out in Section 4.2. This means adopting an approach that seeks to reflect and restrain the law. The restraint necessary to avoid the overzealous application of legal doctrine is achieved through an un-personified application of the *Nathan* maxim. This can, therefore, be seen as a refinement of the comprehensive approach set out in Chapter 3 and, in this way, the flexibility inherent to the source of income inquiry is maintained, and the problems discussed in Section 3.2 continue to be averted.

This refinement may prevent the problems illustrated in Section 4.2, however, deeper problems with the source enquiry remain. These problems arise out of the foundational premise that a universal test for source of income cannot be developed and, therefore, that a practical, hard matter-of-fact approach must be taken. These problems may, therefore, be thought of as arising out of the application of a meta-practical person principle, under which the substance of the principle is accepted but not its anthropomorphised form. This section will argue that, by succumbing to the notion that source of income must be defined in this manner, the court in *Nathan*

created a flawed concept that would in the first place be unable to give guidance on complex legal issues and in the second place provide an unduly flexible criterion for decision-making.

These two problems, it is argued, arise out of the very nature of the source of income enquiry if it is seen as having "no precise or technical reference."[188] Furthermore, if – as we have been led to believe thus far – "the exactness which the lawyer is prone to seek must be consciously set aside"[189] when deciding source of income, a number of negative down-stream effects will likely arise. These will be discussed in Section 4.4.

4.3.1. INABILITY TO DEAL WITH COMPLEX ISSUES

The first problem that arises out of the general conception of source of income as a practical, hard matter of fact is that the enquiry is not suited to dealing with complex legal issues. This is because the refined comprehensive approach (the two-step framework applied through the lens of practicality and factual-precedence of the *Nathan* maxim) requires certain legal questions to be determined practically. This is despite the fact, however, that many aspects of the law are designed to operate in a manner that is contrary to practical application. This problem was illustrated in the *Lever Brothers* case when Watermeyer CJ held 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* (emphasis added).[190]

The problematic dichotomy between abstract legal rules and concrete practical approaches is also highlighted by Schreiner JA who notes that, "the location of an incorporeal in space by a *rule of law* carries a flavour of *artificiality*" (emphasis added).[191] What Schreiner JA notices, therefore, is that the artificiality of such rules is clearly in conflict with practicality, which by its nature is not artificial.

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[188] *Thorpe Nominees Pty Ltd v FCT* 88 ATC 4886.
[189] *Thorpe Nominees Pty Ltd v FCT* 88 ATC 4886.
[190] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 449.
[191] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 462.

Before delving deeper into this issue, a distinction must first be drawn between the current problem – that complex legal issues cannot be reconciled with practicality – and the problem set out in Section 4.2.2 – that the personified practical person operates to conflate factual and legal questions. The problem associated with the personification of the practical person is that it unduly merges objective and subjective standards with the result that there is no mechanism to determine when it is appropriate to depart from accepted legal rules. By removing the anthropomorphic visage, it is shown that the true operation of the principle, as a tool to prevent the overzealous application of the law to the facts, can be maintained without inducing the confusion illustrated in *Lever Brothers*. What the "reflect and restrain" approach does not do is remove practicality from the question. Indeed the method of restraining the law is through deference to the practicality and the hard facts of the case. In other words, it is through the application of the *Nathan* maxim. The present problem, however, is with the very application of practicality to issues that have been defined abstractly. This issue, therefore, cannot be removed by looking at the principles in a different manner as it is tied to the very nature and existence of the principle itself.

Regarding the present problem, it is stated that the question of source is not a legal issue but a factual question. The relationship between factual and legal questions may, however, be blurred in difficult cases. It is clear that Watermeyer CJ's two-step framework provides an efficient method of reconciling the inherent practicality of source of income with a legal framework. This is because the framework is crafted as, ostensibly, two questions of fact. First, what is the originating cause of income and, second, where is it located. These questions do not, however, account for the entire enquiry. This is because there are legal questions that *must* be answered before the question of fact can be addressed. In the *Lever Brothers* case these legal issues meant an adequate description of the incorporeal debt.[192] After all, incorporeals of this kind are created by operation of the law and must, therefore, be fully described in legal terms. Seen in this light, Watermeyer CJ's two questions of fact are no more than methods of accessing deeper legal questions.

[192] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 450.

According to the *Nathan* maxim, however, these deeper legal questions are to be determined practically. The effect of this is to dilute the concept of practicality to such a degree that it can no longer perform the function for which it was originally introduced – that is to prevent an application of legal principles to the case at hand. It follows that the practical approach becomes synonymous with a legalistic approach to certain questions. This approach is, therefore, a tautology for the judge's own legalistic reasoning. This is something with which Watermeyer CJ and Schreiner JA seem comfortable, as they both equate the views of the practical person with those of the theoretical lawyer.[193]

4.3.2. PROBLEM OF INHERENT FLEXIBILITY

The second problem with the conception that source of income is a practical question is that it provides an unduly flexible criterion to be used in the judicial decision-making process. As illustrated in Chapter 3, however, it is one of the key characteristics of the practical person principle (as a personification of the *Nathan* maxim) that it grants judges the flexibility necessary to overcome the problems inherent to the source of income enquiry that were outlined in Section 3.2. This lack of specificity necessarily flows from the task that the practical person was enlisted to perform.

The problem with flexibility is that, as Balazs notes, "reality is in the eye of the beholder."[194] While on the one hand, this reality – the factual matrix of the case – is what the practical person principle is intended to facilitate the judge in arriving at, on the other hand, this flexibility does not provide judges with adequate direction in achieving this. Kuan argues further, that this practical approach is "extremely flexible and does not offer much guidance to the courts so that in unusual factual situations it is possible for the courts to go astray."[195] In essence, judges are given too much leeway to introduce extraneous considerations into their decision-making process under the guise of practicality. This can happen in one of two broad ways: first, the

[193] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 457, 464.
[194] J Balazs "An Introduction to Australia's Tax System: How Source is Determined" (2009) 7 http://www.blwllp.com/getattachment/a00ed84b-b7b8-429a-b39f-2e875a91e6a6/How-is-Source-Determined--.aspx (accessed 8 May 2013).
[195] LH Kuan "Determining Sources of Income – A New Guiding Principle?" (1991) *Singapore Journal of Legal Studies* 517 at 520.

principle can be easily manipulated *consciously* to suit one's own purposes; second, the principle is liable to *subconscious* manipulation. These will be discussed in turn below.

Conscious Manipulation

One of the ways in which the flexibility inherent to the practical approach can affect the outcome of a judgment is through conscious manipulation. Such manipulation, however, need not be malicious; the principle may be co-opted simply in support of a judge's genuinely benevolent findings in a matter. In other words, the judge may employ the tool incorrectly as an after-the-fact justification rather than a tool that should be used to come to a conclusion. Whatever the motivation for such a use of the principle of practicality, it is an incorrect approach. Furthermore, there seems to be evidence of this occurring in the judgments of Watermeyer CJ and Schreiner JA in *Lever Brothers* as they each presented legal arguments in support of a position, and subsequently held that the practical person would have concurred with these conclusions.

There is no evidence of maleficence on the part of the judges in the *Lever Brothers* case; however, this does not preclude the principle being used in such a manner in other cases. This is largely because the tractability offered by practicality provides sufficient room to introduce ulterior motivations into their judicial-making. In this way, judges are given leeway to come to conclusions that are not founded in law or some other principled application of reason. Instead, they may make conclusions on the basis of any number of self-interested preconceptions. It would be beyond the present scope to investigate the plethora of potential motivators, however, given that they are there to operate; it is concerning that the practical approach does not guard against them. Furthermore, given that it is necessary for the judiciary to be held in high regard – in order for its decisions to be legitimate – it would be problematic if the judiciary were seen to be making decisions on the basis of the personal interests of its judges.

Subconscious Manipulation

As well as the conscious use of the practicality principle as a tool to support one's argument, the flexibility inherent to this concept may lend itself to being manipulated

subconsciously. Judges, as with all people, are subject to a host of identified psychological biases. These come in various forms: some appear to be innate to all people and are possibly rooted in our biology while others are acquired through the elaborate process of socialisation that moulds us throughout our lives. A quick glance through the law reports reveals, for example, how the changes in social attitude are reflected in changes of judicial approach. A good example of this is the dichotomous approaches taken in *Duke of Westminster v IRC*[196] and *COT v Ferrera*.[197] In the former case it was held that tax avoidance was a legitimate pursuit, as people should be entitled to structure their business activities so as to minimise their tax exposure so long as this is within the limits of the law. In the latter case, however, such avoidance was held to be "an evil"[198] by which certain taxpayers foist their civic responsibility to contribute to the *fiscus* onto those around them.

Recent research has taken strides toward uncovering some of the biases implicit in all people and in judges specifically. Sarnikar, Sorensen and Oaxaca[199] studied data obtained from the United States Sentencing Commission, and came to the conclusion that on average women receive "15.4 months less prison time than men." This was after controlling for the severity of the offence, the criminal history of the offender and "gender [*sic*] differences in individual circumstances."[200] These data clearly point toward a strong bias on the part of a number of judges toward giving women more lenient prison sentences.

Over and above these biases, people are also subject to what has been termed the "Bias Blind Spot" which causes us to be comparatively unaware of our own biases as opposed to those of others.[201] The cumulative effects of being biased and unaware of

[196] *Duke of Westminster v IRC* [1936] AC 1 14.
[197] *COT v Ferrera* 1976 (2) SA 653 (RAD).
[198] *COT v Ferrera* 1976 (2) SA 653 (RAD) 656F.
[199] S Sarnikar, T Sorensen and RL Oaxaca "Do You Receive a Lighter Prison Sentence Because You are a Women? An Economic Analysis of Federal Criminal Sentencing Guidelines" (2007) *IZA Discussion Paper No. 2870* http://ftp.iza.org/dp2870.pdf (accessed 5 August 2013) 32.
[200] S Sarnikar, T Sorensen and RL Oaxaca "Do You Receive a Lighter Prison Sentence Because You are a Women? An Economic Analysis of Federal Criminal Sentencing Guidelines" (2007) *IZA Discussion Paper No. 2870* http://ftp.iza.org/dp2870.pdf (accessed 5 August 2013) 32.
[201] E Pronin, DL Lin and I Ross "The Bias Blind Spot: Perceptions in Self Versus Others" (2002) 28(3) *Personality and Social Biology Bulletin* 369 at 379; J Erlinger, T Gilovich and L Ross "Peering into the Bias Blind Spot: People's Assessments of Bias in Themselves and Others" (2005) 31(5) *Personality and Social Biology Bulletin* 1 at 10.

it provides fertile ground for, albeit subconsciously. The blind spot bias means, furthermore, that you cannot always take steps to achieve greater objectivity.

It is possible that the conclusions reached in the *Lever Brothers* judgment were affected by subconscious biases of some kind. Although there is no direct evidence of this occurring, as is necessarily the case with subconscious bias, there are a number of historical events that would have likely influenced the judges' reasoning. Watermeyer CJ, for example, initially studied mathematics at Cambridge University.[202] It is, therefore, likely that the insights he gained from this background spilled-over into his particular judicial style. The Chairman of the Special Income Tax Court even noted that "[Watermeyer CJ's] knowledge of mathematics stood him in good stead and his lucid judgments clarified many obscure points in this difficult branch of the Law."[203] Watermeyer CJ's mathematical style is further evidenced by his routinely rigorous and systematic approach to the law.[204] In this vein, Watermeyer CJ has also been described as "an erudite Roman-Dutch lawyer."[205] As Thackwell[206] shows, a number of Watermeyer CJ's decisions involved an exposition of the Roman-Dutch law at the core of the case. This style of evaluating the "first principles" of a matter is also illustrated in Watermeyer CJ's approach to the facts in *Lever Brothers*. Overall, it seems likely that the approach taken by Watermeyer CJ in *Lever Brothers* was influenced by his mathematical training as well as the high esteem in which he held Roman-Dutch law. It is not inconceivable, therefore, that the systematic two-step framework that the *Lever Brothers* case is famous for is a product of Watermeyer CJ's attitude of mind over and above the particular requirements of the source of income enquiry.

Schreiner JA on the other hand obtained a Bachelor of Arts from the University of the Cape of Good Hope.[207] He then proceeded to read for his BCL at Cambridge University.[208] In direct contrast to Watermeyer CJ, Schreiner JA reported only

[202] Anonymous "The New Chief Justice" (1933) 2 *South African Law Times* 48 at 48.
[203] GGS (only initials available) "Mr Justice Watermeyer" (1923) 40 *SALJ* 99 at 104.
[204] R Thackwell *The Contribution Made by Mr Justice EF Watermeyer to South African Tax Jurisprudence* (Unpublished Masters Thesis, Rhodes University 2010).
[205] GGS (only initials available) "Mr Justice Watermeyer" (1923) 40 *SALJ* 99 at 104.
[206] R Thackwell *The Contribution Made by Mr Justice EF Watermeyer to South African Tax Jurisprudence* (Unpublished Masters Thesis, Rhodes University 2010).
[207] CRP (only initials available) "*Hon. Mr. Justice O.D. Schreiner"* (1938) 55 *SALJ* 1 at 1.
[208] E Kahn "Oliver Deneys Schreiner - the Man and his Judicial World" (1980) 97 *SALJ* 566 at 569.

attending one lecture on Roman-Dutch law and his judgments seldom involved a deep investigation into the historical foundations of the law.[209] In fact, upon his promotion to the Appellate Division Schreiner JA described the different approach taken by Watermeyer CJ as follows:

> The work is markedly more thoroughly done than when one sits in the Provincial Division . . . [Some] matters are heard . . . that one would be ready to dispose of in a rough and ready fashion without much delay, but we go over them with the utmost care and choose the words . . . that leave no room for mistake . . . The Chief, Billy (Watermeyer CJ), is a very wise judge with a big and well-stored brain. He guides our discussions with the artistry of a company chairman.

Despite his respect for Watermeyer CJ, it is not surprising that Schreiner JA – coming from a distinctly different background – would come to different conclusions in the *Lever Brothers* case; especially when given the opportunity to depart from fixed legal doctrine.

Regarding Davis AJA, it is interesting to note that he had once bragged that he had never come to a different conclusion from his good friend Watermeyer CJ.[210] Curiously enough this statement remained true for the *Lever Brothers* case.

Overall, it is argued that judges – as is the case with all people – are not objective, unbiased arbiters of justice. Instead they are perpetually influenced by a complex set of biases and predispositions that tint the lens through which they see the world. More importantly, our pre-disposition to believe that our view of the world is the correct one keeps us unaware of the biases that cloud our view. The result of this is that the popular adage that lawyers must tailor their case to the particular sentiments and sensibilities of the judge has become almost cliché. Bringing these conclusions to the present matter, the problem with the principle that source of income should be determined through a lens of practicality is that it gives judges license to remain uncritical of their biases. Instead, an approach predicated on practicality seems to invite a subjective – common sense – approach to a matter whereas other approaches attempt to dissuade it. It is, therefore, evident that the flexibility offered by the

[209] E Kahn "Oliver Deneys Schreiner - the Man and his Judicial World" (1980) 97 *SALJ* 566 at 590.
[210] E Kahn *Law, Life and Laughter: Anecdotes and Portraits* (1991) 35.

practical approach to determining source of income is problematic as it leaves such cases vulnerable to the subconscious sensibilities of the particular judge.

4.4. DOWN-STREAM NEGATIVE EFFECTS

It is illustrated above that the flexibility offered by an approach that is based on practicality means that the outcome of such cases will be open to manipulation – both consciously and subconsciously. Over and above this, such an approach is not well suited to dealing with complex legal issues that require an analysis of legal fictions and metaphor. It has also been made clear that these problems arise out of the substance of the source of income enquiry and not its form. In this way, these problems have been shown to arise out of the very conception that source of income is to determined practically and factually. Seen in this light, the characteristics of the practical person that were outlined in Chapter 3 prove to create greater problems than the one that they propose to solve. These problems can, therefore, be seen as the down-stream effects of adopting a flexible practical approach to determining source of income. In other words, these problems are the direct result of the decision that there should be no ultimate test for the determination of source of income.

4.4.1. UNDERMINES JUDICIAL PRECEDENT

The first problem that results from the conception that there should be no ultimate test for the determination of source of income is that it involves an excessive erosion of the doctrine of judicial precedent (*stare decisis*). As illustrated in Section 3.4 one of the key effects of the *Nathan* maxim is that matters should be decided on a case-by-case basis. This means that, as confirmed in *FCT v Efstathakis*,[211] "the answer is not to be found in cases but in the weighing of the various factors which the cases have shown to be relevant." The practical approach was, therefore, developed in order to prevent a strict application of legal rules and instead facilitate an approach based on a kind of factual-precedence.

[211] *FCT v Efstathakis* (1979) ATC 4256 4259.

In order to sustain such an approach, however, the role of judicial precedent must be sacrificed. Nevertheless, according to Rycroft,[212] judicial precedent is important for maintaining uniformity in the legal system. Furthermore, Rycroft argues that abandoning the concept "ultimately reduces public confidence in the courts and the independence of judges."[213] The result of this is that judicial decisions become more arbitrary as they are left to the response of the particular judge. Kruuse also notes that the primary value of judicial precedent is its promotion of legal certainty – This will be discussed further in Section 4.4.3. In sum, judicial precedent promotes a necessary consistency in the legal system that ensures that similar cases are treated similarly.

Despite the foundational importance of the doctrine of judicial precedent in our judicial system as well the advantages of its application, there have been several proponents of a softening of the doctrine in recent years.[214] In this regard, Woolman and Brand ask: "should we slavishly adhere to *stare decisis* or the application of precedent for the purposes of legal stability even where such stability works an injustice?"[215] Similar thinking has lead Rycroft to propose a set of criteria that may be used when considering departing from judicial precedent.[216] These include the following questions: has the rule proved to be intolerable; would reliance on the rule lead to a special kind of hardship in the present case; have the principles of law been abandoned over time; have the facts changed so as to warrant a different conclusion; is the recent decision in conflict with a prior sound decision; and does the decision prevent the achievement of other important legal objectives? This checklist provides a useful tool for determining when it would be appropriate to depart from judicial precedent. Importantly, what this approach achieves is a sound method of softening the doctrine in such a way that it does not give judges "carte blanche with each and

[212] A Rycroft "The Doctrine of Stare Decisis in Constitutional Court Cases" (1995) 11 *SAJHR* 587 at 588.
[213] A Rycroft "The Doctrine of Stare Decisis in Constitutional Court Cases" (1995) 11 *SAJHR* 587 at 588.
[214] H Kruuse "'Here's to You, Mrs Robinson': Peculiarities and Paragraph 29 in Determining the Treatment of Domestic Partnerships" (2009) 25 *SAJHR* 380; A Rycroft "The Doctrine of Stare Decisis in Constitutional Court Cases" (1995) 11 *SAJHR* 587; S Woolman and D Brand "Is there a Constitution in this Courtroom? Constitutional Jurisdiction after Afrox and Walters" (2003) 18 *SA Public Law* 37.
[215] S Woolman and D Brand "Is there a Constitution in this Courtroom? Constitutional Jurisdiction after Afrox and Walters" (2003) 18 *SA Public Law* 37 at 38.
[216] A Rycroft "The Doctrine of Stare Decisis in Constitutional Court Cases" (1995) 11 *SAJHR* 587.

every judgment."[217] Accordingly, it does not "bring adjudications… into the same class as a restricted railroad ticket, good for this day and train only."[218]

The erosion of the doctrine of judicial precedent that is the result of the practical approach to determining source of income is, however, not subject to the reasoned constraints set out above. Instead, it is a key aspect of the practical approach that cases are decided without deference to previous judgments and that judges *are* given carte blanche with the particular facts. It is a blanket abolition of the doctrine. It follows that the flexible practical approach truly brings such judgments into the class of restricted railroad tickets and is, therefore, unwarranted.

4.4.2. RETROSPECTIVE APPLICATION OF THE LAW

The second problem with the conception that there should be no ultimate test for the determination of source of income is that it allows for a retrospective application of the law. In a constitutional democracy where the courts have the power of judicial review – as is the case in South Africa due to section 1 of the Constitution[219] – there is some degree to which judicial decisions will alter the law and, therefore, apply the law retrospectively. This is especially the case when the Constitutional Court declares certain legislation to be unconstitutional and, therefore, invalid. It is, however, impermissible for the law to apply retrospectively as this would have the unjust result of holding people accountable to standards that have not yet been established. In order to avoid these problems, the doctrine of "objective constitutional invalidity,"[220] operates to presume that such legislation was always invalid due to its conflict with the Constitution and that all the court has done is confirm this invalidity.

In cases regarding the determination of source of income a similar problem appears. This problem is that the case must be determined practically on its particular facts; this means that the judges are making a decision on what is practical as the facts of each case arise. This results in a retrospective application of the law. Ordinarily, however, a fiction similar to that of the doctrine of objective constitutional invalidity

[217] H Kruuse "'Here's to You, Mrs Robinson': Peculiarities and Paragraph 29 in Determining the Treatment of Domestic Partnerships" (2009) 25 *SAJHR* 380 at 388.
[218] *Smith v Allwright* (1944) 321 US 649.
[219] The Constitution of the Republic of South Africa, 1996.
[220] *Moise v Greater Germiston Transitional Local Council* 2001 (4) SA 491 (CC) para 11.

could operate which would state that the practical outcome has always been known and that, therefore, the legal position on a particular set of facts would have been clear to the parties before the transaction was entered into. The issue arises, however, when the flexibility of the practical approach is considered. In Section 4.3 it was argued that such flexibility allows for a significant degree of judicial discordance. The result of this is that it becomes impossible to predict the outcome of a case in advance. Such an operation of the practical approach, therefore, prevents such a fiction from operating. Hence, the flexibility inherent to the practical approach has the absurd result of holding people to a standard that cannot have been known before the judgment has been decided.

Allowing cases to be decided on the basis of a case-by-case application of a flexible standard has the further result of undermining the principle of *ignorantia jusis non excusat* (that ignorance of the law is not an excuse). This principle essentially presumes that everyone has knowledge of the law. Its purpose is to prevent the defence that a person was unaware of the law and, therefore, should not be punished for a contravention thereof. In order for this principle to be given credence there is a minimum level of legal understanding that is required in the general public. If cases are being decided on a case-by-case basis with deference to an approach that facilitates judicial discordance there is no way for people to be able to know the outcome of a particular case in advance. In other words, people will be unable to bring their actions in line with the law before judicial pronouncement.

The effect of the above conclusions is essentially that the law, as it applies to determining source of income, can be seen as a creature of retrospective application. It would, therefore, be a fallacy for people to be expected to know the law in a particular case where it is yet to be created. The further effect of this is that people are unable to structure their business transactions in accordance with the law.

4.4.3. UNDERMINES LEGAL CERTAINTY

The cumulative effect of the above two submissions strongly suggests that the conception that there should be no ultimate test for the determination of source of income radically erodes legal certainty. It does this by giving judges too much scope

to deal with cases individually and by allowing them to use a concept that provides too much freedom. The *Lever Brothers* judgment is a prime example of the discordance that can result from judges being given "too much rope."

Legal certainty, it is contended, is achieved through the complex interplay of a number of aspects of the legal system: the law must be sufficiently ascertainable and understandable to the general public; the law should – as much as constitutionally defensible – align with public perceptions of it; and the law should be sufficiently stable over time.[221] The practical approach to determining source of income, predicated on the idea that determining source of income cannot be subject to a universal test, has the result of undermining any certainty regarding the source of income. Such certainty is fundamental to the South African legal system. Any erosion thereof accordingly has negative consequences for the legal system as a whole.

The importance of legal certainty was also recognised by Adam Smith in 1776 when he included it as one of his four canons of taxation. Smith argued that, in order to achieve justice and utility, a system of taxation must follow four maxims: equity, certainty, convenience of payment and economy of collection.[222] Regarding certainty, Smith remarked, "[t]he time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person."[223] Uncertainty in a system of taxation fosters, according to Smith, "insolence" and "corruption."[224] Overall, Smith concluded that

> "[t]he certainty of what each individual ought to pay is, in taxation, a matter of so great importance, that a very considerable degree of inequity, it appears, I believe, from the experience of all nations, is not near so great an evil as a very small degree of uncertainty."[225]

[221] DW Freedman Constitutional Law: Structures of Government in WA Joubert (ed) *LAWSA* Vol 5(3) (2012) para 18.
[222] A Smith *An Inquiry into the Nature and Causes of the Wealth of Nations* 3 ed (1789) 255-258.
[223] A Smith *An Inquiry into the Nature and Causes of the Wealth of Nations* 3 ed (1789) 256.
[224] A Smith *An Inquiry into the Nature and Causes of the Wealth of Nations* 3 ed (1789) 256.
[225] A Smith *An Inquiry into the Nature and Causes of the Wealth of Nations* 3 ed (1789) 257.

4.4.4. UNCONSTITUTIONALITY

The cumulative effect of subverting judicial precedent, the prospective operation of the law and legal certainty is to whittle away the principle rule of law. The rule of law is a foundational value of our democracy and is enshrined in section 1(c) of the Constitution.[226] One of the core components of the rule of law is the principle of legality.[227] This requires that: "that the law must be general in nature; that it must be *prospective* and not retrospective; that it must be *clear*, open and *relatively stable*" (emphasis added).[228] In other words, to the extent that the source of income enquiry allows for the legal position to be uncertain until judicial pronouncement, it creates an environment that is contrary to the principle of legality, the rule of law and is, therefore, unconstitutional.

4.5. CONCLUSION

In Chapter 3, the practical person principle was considered as a tool that may be used to overcome certain problems that are inherent to the source of income enquiry. From this, certain characteristics of the principle and its operation became evident. In particular, it is clear that the principle provides an anthropomorphised standard for the determination of source of income.

The first part of Chapter 4, therefore, set out to critically analyse this standard. This involved a discussion of two key problems that arise out of personifying the approach to determining source of income. The first of these problems is that there cannot be a comprehensive description of the characteristics of the personified standard. This is because any attempt to homologise the differences inherent to a heterogeneous society would fail to account for important cultural differences as well as South Africa's constitutional commitment to recognise and rectify the effects of institutionalised discrimination. The second problem with a personified standard is that analytically separate enquiries are conflated. Specifically the distinction between a subjective (fact-based approach) and an objective (norms-based approach) is lost. The result of this is that judges are not given guidance in mediating these tensions and this leads to

[226] The The Constitution of the Republic of South Africa, 1996.
[227] *Fedsure Life Assurance Ltd v Greater Johannesburg Transitional Metropolitan Council* 1998 (12) BCLR 1458 (CC) para 58.
[228] DW Freedman Constitutional Law: Structures of Government in WA Joubert (ed) *LAWSA* Vol 5(3) (2012) para 18.

a “whipsaw” between the two. There is evidence of this occurring in the Lever Brothers case with Watermeyer CJ and Schreiner JA adopting a norms-based approach while Davis AJA adopted a fact-based approach.

These problems arise out of the anthropomorphisation of the approach to determining source of income and are, therefore, capable of being overcome by re-describing the principle. They are, accordingly, problems with the approach to determining source of income in practice and not in principle. By looking at the underlying operation of the practical person principle, a mechanism for restraining the overzealous application of legal rules, it is possible to overcome the problems discussed above. This involves re-casting the principle as a method of reflecting and restraining the law.

The second part of Chapter 4 addresses problems with the source of income enquiry in principle. These problems arise out of the fundamental premise that a universal test for source of income cannot be developed and, therefore, that a practical, hard matter-of-fact approach must be taken. The first problem is that a practical approach to determining source of income in incapable of dealing with complex legal issues. In particular, it is recognised that the dichotomy between abstract legal rules and concrete practical approaches cannot be overcome without diluting the concept of practicality to such a degree that it can no longer perform the function for which it was originally introduced.

The second problem with the conception of source of income as a practical question is that it provides an unduly flexible criterion for judicial decision-making. This flexibility allows the principle to be consciously co-opted by judges as a tool to support their own conclusions in a matter. In this way, cases may be decided according to the personal desires of judges, be they benevolent or malevolent. This will have the effect of undermining the legitimacy of the judiciary. Over and above this, the flexibility of the practical approach also lends itself to subconscious manipulation. Through the operation of a number of biases implicit in all people, judges may find their objectivity in a matter eroded. It is difficult, furthermore, for judges to become aware of these biases as a method of achieving greater objectivity, as the blind spot bias makes us less likely to recognise our own biases than those of

others. The cumulative effect of being biased and unaware of it provides fertile ground for the misuse of the practical approach to determining source of income.

These two problems with the approach to determining source of income in principle give rise to a number of down-stream negative effects. The first of these is that judicial precedent is eroded in favour of a kind of "factual-precedence." While it is argued that a softening of the principle of judicial precedent is not necessarily problematic, it is argued that the unreasoned, blanket abolition of the doctrine is unwarranted. The second down-stream effect is that the practical approach allows for a retrospective application of the law. This is because the flexibility of the approach prevents people from knowing the legal position of a particular situation in advance and, therefore, from being able to arrange their business transactions in accordance with the law. This has the further effect of undermining the principle that people are presumed to have knowledge of the law. The third down-stream effect is that legal certainty is undermined. This is because judges are given too much scope to deal with cases individually and with too much freedom. The cumulative effect of all of this is that the principle of the rule of law, a foundational value of South Africa's Constitution, is undermined. The current approach to determining source of income is, therefore, unconstitutional.

Given the conclusions reached above, it can be argued further that the practical approach to determining source of income, paradoxically, undermines a key aspect of its operation. In Section 3.4.6 it is argued that one of the characteristics of the operation of the practical person is to facilitate bringing the law in line with public perceptions of it. The flexibility associated with the practical approach to determining source of income, however, means that such an outcome is by no means certain. To the extent that judges may manipulate the source of income enquiry – either to suit their own ends or as subjects of ingrained cultural and biological biases – the result will not necessarily be a greater harmonisation of the law and public morality. Instead the reverse would seem to be more likely.

CHAPTER 5: SUGGESTED SOLUTION

> *No question arises in this case as to the validity of taxation measures which have some degree of extra-territorial operation; we are concerned solely with the application of a statute, properly construed; to facts, properly analysed and assessed.*
>
> – Schreiner JA, *Lever Brothers*

5.1. INTRODUCTION

The practical approach to determining source of income was predicated on the notion that a definitive test would operate too rigidly and give rise to unjust results. The *Nathan* case, therefore, set out to "emphasize [*sic*] the factual nature of the inquiry and that the touchstone [is] practical reality."[229] The effect of this maxim was to construct the source of income inquiry as a practical question with the requisite flexibility to avoid the creation of a definitive test. This flexibility, as evident from the previous discussion, proved to be a "double-edged sword" simultaneously overcoming the problems outlined in Chapter 3 and creating the deeper problems considered in Chapter 4.

This chapter will examine the possibility of an alternative approach to determining source of income. It will be argued that an approach to determining source of income that is predicated on philosophical analysis rather than practical convenience will give rise to a more desirable solution. In this regard, the statutory interpretative basis of the practical person will first be examined. Following this, a brief examination of the relative merits of practical or common sense approaches versus legal-philosophical approaches will be undertaken. From this it will be argued that a philosophical approach provides a more robust mechanism for such enquiries. This will then be used as the foundation to an alternative approach for the determination of source of income. The approach taken in the case of *Kergeulen Sealing and Whaling Co Ltd v*

[229] *Thorpe Nominees Pty Ltd v FCT* 88 ATC 4886.

CIR (*Kergeulen*)[230] will be used as the basis for a superior method for determining source of income. Finally, this method will be applied to the facts of *Lever Brothers* in order to illustrate its effectiveness.

5.2. THE LEGISLATIVE BASIS OF THE PRACTICAL APPROACH

It has been noted in Sections 2.4 and 3.2.1 that the practical approach to determining source of income arose out of a literalist/intentionalist interpretation of the income tax legislation. The legislature's failure to provide a definition for source of income led judges, operating under this school of interpretation, to the conclusion that source of income should not be subject to a strict definition. Consequently, the *Nathan* maxim, which requires source of income to be determined practically and factually, was a necessary aspect of the source of income enquiry as authoritatively directed by the legislature. Finding source of income was, therefore, a practical question, not because judges decided this to be the case, but rather because it had been envisioned as such by the legislature.

Under a supreme Constitution, parliament is no longer sovereign.[231] This change opened the door to new theories of statutory interpretation, including the purposive approach. This approach prioritises interpretations of legislation that enhance its goals rather than those that arise strictly out of its phraseology. It is now possible, therefore, to depart from the wording of legislation where this would better achieve the purpose for which the legislation was enacted.

In the present case, the notion that determining source of income is a question that should be approached practically is one that may, therefore, be disregarded if this would better achieve the legislative purpose. Seen in this light, it may be possible to extricate the source of income enquiry from its bonds to the practical approach. The relative merits of practicality and philosophical analysis will now be examined against their ability to better achieve the legislative purpose. The key argument in this regard is that one of the key purposes of all legislation is that it provides an explicit codification of the legal position in order to minimise misunderstandings and promote

[230] *Kergeulen Sealing and Whaling Co Ltd v CIR* 1939 AD 487.
[231] Section 1 of the Constitution of the Republic of South Africa, 1996.

legal certainty.[232] The analysis of the practical approach to determining source of income undertaken in Sections 4.3 and 4.4 shows that such an approach hinders the attainment of legal certainty and is, therefore, in conflict with the overall purpose of income tax legislation. Any approach that promotes legal certainty would, accordingly, be preferred.

5.3. PHILOSOPHICAL ANALYSIS

In Chapter 4 it was shown that a practical approach to questions of source of income gives rise to a number of negative consequences for the legal system as a whole. Both Russell[233] and Chesterton,[234] however, argue for the merits of a philosophical approach to solving complex social problems. This is in distinct conflict with the remarks of Davis AJA in *Lever Brothers* who appears to be sceptical of the value of philosophical reasoning. His conclusion in this regard was that the "legal theorist… by resolutely shutting his eyes to all the facts, could prove that black was white."[235] In line with this, Russell notes that it is common to "doubt whether philosophy is anything better than innocent but useless trifling, hair-splitting distinctions, and controversies."[236] This section will argue that philosophical thinking has two key advantages over practical, or common sense, approaches: first, that it that it has the capacity to yield definitive answers where a practical approach cannot; and, second, it provides room for a thorough investigation, which is a good in and of itself.

In the first instance, philosophy provides a platform for the examination of complex social, political, economic and legal questions. In this regard, Chesterton argues that the concern some people have that philosophy is "a tangle of complicated notions" misses the point. It is not philosophy that is complicated; instead it is the "modern situation" that is complicated.[237] Chesterton argues further that the current situation has resulted from a lack of philosophical investigation and instead we need philosophy to *simplify* the world.[238]

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[232] L du Plessis *Re-Interpretation of Statutes* (2002) 22.
[233] B Russell *The Problems of Philosophy* (1959).
[234] GK Chesterton *The Common Man* (1950).
[235] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 465.
[236] B Russell *The Problems of Philosophy* (1959) 1.
[237] GK Chesterton *The Common Man* (1950) 1.
[238] GK Chesterton *The Common Man* (1950) 1.

The major strength of philosophical reasoning is that it is driven exclusively by the pursuit of knowledge. In order to achieve this, the philosophical enquiry is characterised by an approach that is impersonal, abstract and universal. This is because, without these attributes, any conclusions reached will be confined by "the trammels of customary beliefs and traditional prejudices."[239] Russell argues further that

> [t]he man who has no tincture of philosophy goes through life imprisoned in the prejudices derived from common sense, from the habitual beliefs of his age or his nation, and from convictions which have grown up in his mind without the co-operation or consent of his deliberate reason.[240]

The philosophical process of reasoning through thorough investigation and contemplation of a matter is, accordingly, an effective way of guarding against the invasion of common sense. It is argued that, only by undertaking a philosophical evaluation of a matter can steps be taken in the direction of an ultimate truth. Practicality on the other hand, argues Chesterton, may take progressive steps toward this; however, it is too focused on efficiency and the natural evolution of things to achieve meaningful knowledge. He argues further that "the practical man cannot be expected to improve the impracticable muddle" in which we find ourselves.[241]

The second great benefit of philosophy is that, even if it cannot provide a definitive answer on a subject, it has a positive effect on the "student" of philosophy. In this regard, Russell argues that the study of philosophy provides a good for the mind, which is just as important as goods for the body.[242] This is because, according to Russell,

> however slight may be the hope of discovering an answer, it is part of the business of philosophy to continue the consideration of such questions, to make us aware of their importance, to examine all the approaches to them, and to keep alive that speculative

[239] B Russell *The Problems of Philosophy* (1959) 3.
[240] B Russell *The Problems of Philosophy* (1959) 2.
[241] GK Chesterton *The Common Man* (1950).
[242] B Russell *The Problems of Philosophy* (1959) 2.

> interest in the universe which is apt to be killed by confining ourselves to definitely ascertainable knowledge.[243]

Importantly, it is in attempting to answer questions that may ultimately be unanswerable that philosophy presents its greatest advantage: being confronted with uncertainty and doubt frees the mind of the philosopher to the vast array of potentialities and, "because these questions enlarge our conception of what is possible, [it will] enrich our intellectual imagination and diminish the dogmatic assurance which closes the mind against speculation."[244]

It is due to the combination of these two results of philosophical thinking that it is argued that a philosophical approach would be better suited to the problem of finding source of income. In the first instance it is argued that philosophical thinking, through its emphasis on independent critical analysis, provides a powerful framework with which to address the question of source of income. Through such an approach it may be possible to find a *definitive test* for determining source of income where an approach predicated on practicality has failed. In the second instance, and if, after a rigorous philosophical evaluation, such a test proves to be impossible; it is argued that the process of coming to such a conclusion would have greatly enhanced the mind of the thinker. A judge who is tasked with such an examination would be confronted with a vast array of possibilities and, in confronting these, would likely be humbled by the process and hopefully left in wonder at the intricacies of the society that has been created around us. A mind that has been opened by such an experience would be, it is argued, better equipped to tackle future quandaries as they arise. It would also be less likely to be "imprisoned by common sense."[245]

The sentiment behind this conclusion is, accordingly, succinctly stated in the following passage by Crane:

> [the practical person] is supposed to be of much more real use to the world than the Theoretical Man. We speak of the man who 'does things' or 'gets things done' with a certain smack and relish as though he, after all, were the fellow worth while.

[243] B Russell *The Problems of Philosophy* (1959) 2.
[244] B Russell *The Problems of Philosophy* (1959) 4.
[245] B Russell *The Problems of Philosophy* (1959) 2.

> Practical implies that he can do things that he has practised. But when he wants a thing done that nobody practised, when he gets one of the real hard knots of life, your practical man is helpless. Then we discover that the great man is the Dreamer with a head full of theories.
>
> The best work is done by the Theorists, in their laboratories, watching test-tubes, in their studies excogitating philosophies, or under the summer trees dreaming of the coming days of gold and singing of their dreams.[246]

Determining source of income, it has been argued throughout, is one of those "hard knots of life" and, therefore, ought to be approached by the philosopher.

5.4. THE *KERGEULEN* APPROACH

If a philosophical approach to determining source of income is adopted, it may be possible, as indicated in Sections 5.2 and 5.3, to design a *test* for the determination of source of income. Such a test would be capable of providing definitive answers to source of income questions and would, therefore, have the effect of avoiding the flexibility associated with the traditional practical approach. This section will argue that the approach to determining source of income that was adopted in the *Kergeulen* case provides a useful framework for the construction of such a test. In order to illustrate the scope and application of the *Kergeulen* approach, the facts of the case will first be set out. The approach taken in *Kergeulen* will then be outlined. Finally, this approach will be applied to the facts in *Lever Brothers* in order to illustrate its effectiveness.

5.4.1. FACTS IN KERGEULEN

The *Kergeulen* case arose out of disputed tax assessments for the 1935 and 1936 tax years.[247] During this time, the Kergeulen Sealing and Whaling Co Ltd (the Kergeulen Company) was in the business of producing and selling whale oil. Its base of operations was aboard a "factory ship that was stationed outside of the territorial waters of the Union [of South Africa]."[248] It also operated a fleet of smaller whale catching ships, which would trawl the Antarctic seas, harpoon whales and tow them

[246] F Crane *Four Minute Essays, Volume V* (1919) referred to in M Gaidica "The Practical Man" *Bytes of Pi* http://bytesofpi.com/post/55805590946/the-practical-man (accessed 25 August 2013).
[247] *Kergeulen Sealing and Whaling Co Ltd v CIR* 1939 AD 487 493.
[248] *Kergeulen Sealing and Whaling Co Ltd v CIR* 1939 AD 487 487.

back to the factory ship where "the oil would be extracted from their carcases."[249] The Kergeulen Company was registered, along with its fleet of ships, in Cape Town where it also had its head office and board of directors.[250] One of the principal purchasers of this oil was Unilever Ltd in London. The Kergeulen Company took issue with the tax assessments on the basis that the income that it had earned was not from a source within the Union of South Africa.[251]

5.4.2. THE KERGEULEN TEST

There were several issues for the Appellate Division to decide in the *Kergeulen* case and the verdict turned largely on matters of the law of contract, which are outside the scope of the present enquiry. What is relevant for the present purposes, however, are the court's *obiter* remarks regarding "the important and crucial question whether these ships are to be regarded as part of the territory of the Union for the purpose of applying the provisions of the Income Tax Act."[252]

As a preface to Stratford CJ's approach to the question of source of income in Kergeulen, it is evident that the tone of the judgment was at all times principled, logical and legalistic. Stratford CJ also credited the masterful enunciation of Roman Dutch law by the Judge-President in the court of first instance in the *Kergeulen* matter, and recognised the importance of careful consideration and deliberation in judicial decision-making.[253] It is on this backdrop that Stratford CJ set out that judges "should at all times be logical in [their] reasoning, and as philosophic and systematic as [they] can in [their] laying down of legal principles."[254] Although these sentiments are noted in preface to a recognition of the importance of serving the best practical purpose in such undertakings, Stratford CJ made it clear that such questions of practical convenience are secondary to the question of legal theory.[255] In this regard, Stratford CJ held that the first question is one of theory, as may be expounded by eminent jurists, and, should an election between equally supported theories be

[249] *Kergeulen Sealing and Whaling Co Ltd v CIR* 1939 AD 487 493.
[250] *Kergeulen Sealing and Whaling Co Ltd v CIR* 1939 AD 487 493.
[251] *Kergeulen Sealing and Whaling Co Ltd v CIR* 1939 AD 487 494.
[252] *Kergeulen Sealing and Whaling Co Ltd v CIR* 1939 AD 487 506.
[253] *Kergeulen Sealing and Whaling Co Ltd v CIR* 1939 AD 487 504.
[254] *Kergeulen Sealing and Whaling Co Ltd v CIR* 1939 AD 487 504.
[255] *Kergeulen Sealing and Whaling Co Ltd v CIR* 1939 AD 487 505.

required, the second question would be to decide the matter on the basis of practical convenience.

This sentiment is in line with the principled approach to determining source of income in *Kergeulen*. Stratford CJ's judgment was founded on "the equitable principles generally found to underlie liability for income tax."[256] Critically it was held that, in order for a levy to be equitable, either the taxpayer must be a resident of that country (this echoes the residency based system of taxation which South Africa later adopted), or the country in question must have facilitated the production of wealth in some way.[257] This may be, for example, by providing some sort of infrastructure for the production of the income in question, such as security, transport systems, natural resources or other state provisions. Overall, therefore, the equity principle requires that, where the production of wealth is enabled by the state, that wealth is capable of being taxed. The equity principle, it is contended, can be seen as a "rights based approach" to taxation; it is a recognition of the state's right, in certain circumstances, to a share in the wealth that it has enabled in order to continue to enable the production of future wealth.

Working in parallel to the equity principle, according to Stratford CJ, is the "effective means principle."[258] This principle requires not only that the state must have the right to tax certain income, but it must also be *capable of enforcing* that levy.[259] In this regard, Stratford CJ held that the income tax legislation was not intended to create empty threats (*brutum fulmen*) and that the act "clearly implies an ability to make the deduction." In sum, the state must be able to collect the tax.

The Kergeulen approach can, therefore, be seen as a two-legged enquiry based on *equity* and *effectiveness*. Income is, therefore, from a source within South Africa if it is equitable – based on the provision of state resources – and effective – based on the state's ability to collect the tax.

[256] *Kergeulen Sealing and Whaling Co Ltd v CIR* 1939 AD 487 507.
[257] *Kergeulen Sealing and Whaling Co Ltd v CIR* 1939 AD 487 508.
[258] *Kergeulen Sealing and Whaling Co Ltd v CIR* 1939 AD 487 507.
[259] *Kergeulen Sealing and Whaling Co Ltd v CIR* 1939 AD 487 507.

In the *Kergeulen* case, the court relied heavily on the fact that the ships were operating outside of the territorial waters of the Union. The ships were, therefore, not making use of any resources held by the Union. Furthermore, it would be "ridiculous,"[260] according to Stratford CJ, to attempt to levy a tax on ships operating in the Antarctic. A tax on the income in question would, therefore, be neither equitable nor effective. The income in question was accordingly not from a source within the Union.

In conclusion, the approach taken in the *Kergeulen* case clearly provides a useful test for the determination of source of income. It does this by reducing the question of source of income to two underlying legal principles: that such a tax must be equitable and effective. From these, it is argued, a body of law can be developed that will, over time, clarify and refine their meaning. In this way, as with rights-based law in general, judicial precedent operates to give greater content to the right in question incrementally.

5.4.3. APPLICATION OF THE KERGEULEN APPROACH TO THE FACTS OF LEVER BROTHERS

The *Kergeulen* case was decided in 1939, just one year before the first tax assessment that was disputed in the *Lever Brothers* case. As such, the test developed in *Kergeulen* was clearly available to the judges in *Lever Brothers*. Furthermore, Watermeyer CJ presided over both cases and, having concurred in the *Kergeulen* judgment, would have been aware of the ambit of its application.[261] It is interesting, however, that Schreiner JA in *Lever Brothers* specifically noted that

> [n]o question arises in this case as to the validity of taxation measures which have some degree of extra-territorial operation; we are concerned solely with the

[260] *Kergeulen Sealing and Whaling Co Ltd v CIR* 1939 AD 487 508.

[261] The link between *Lever Brothers* and *Kergeulen* goes beyond their temporal synchronicity and the overlapping composition of their benches. The facts of these cases are also, interestingly, aligned. As alluded to in Section 5.4.1 the Kergeulen Company sold whale oil to Unilever Ltd, a company that would become a part of the Lever Brothers Corporation. It is, therefore, possible that the oil sold by the Kergeulen Company that gave rise to the income in question in *Kergeulen* was the same oil that the Levers used in the its production of income prior to its arrangements that gave rise to the income in question in the *Lever Brothers* case.

> application of a statute, properly construed; to facts, properly analysed and assessed.[262]

In this statement, Schreiner JA makes it clear that the underlying legal-philosophical basis of source of income was not questioned in the *Lever Brothers* case. It is argued, however, that since such an analysis had already been conducted by the court in *Kergeulen*, it would have been opportune for the court in *Lever Brothers* to assess the facts on that basis. The question of the validity of such taxation measures, therefore, need not have been a question. Nevertheless, the court in *Lever Brothers* took a markedly different approach to determining source of income from that in *Kergeulen*. This difference will be illustrated below by applying the facts in *Lever Brothers* to the *Kergeulen* test.

The first leg of the test is to look at the equity of the tax in question. In the *Lever Brothers* case, a prominent feature of the transaction entered into between Mavibel and Overseas Holdings is that it was undertaken, as inferred by the judges, in contemplation of war in Europe. Moving the assets to South Africa can, therefore, be seen as an attempt to make use of the financial protection South Africa offered. This may suggest that, by provisioning its corporate structures and security, South Africa had enabled the production of wealth and, therefore, ought to be entitled to tax that wealth. There are, however, further factors that may be weighed against this conclusion: the fact that the cession of the original agreement to South Africa was merely incidental to its intended operation – that being to extend credit to a Dutch company; that the interest was paid entirely out of an American company; that an agreement was entered into on the basis that no funds would leave the country and that no income producing activities were carried on in South Africa.

Under the rights based system of taxation, the court would simply be required to balance these competing factors in order to ascertain whether or not the income was enabled by South Africa. On these facts, it would seem that the move to South Africa was clearly incidental to the original credit agreement. While the protection offered by South Africa enabled the contract to proceed without undue difficulty, it did not enable the underlying contract – the substance of which is paramount. Clearly,

[262] *CIR v Lever Brothers and Unilever Ltd* 1946 AD 441 457.

therefore, the fact that Overseas Holdings did not carry out income-producing activities, or produce any wealth, in South Africa would be of great importance. Consequently, it would seem that under the equity principle South Africa would not be entitled to tax the income in question.

Regarding the second leg of the test, Overseas Holdings paid the interest to Levers out of dividend income earned on the shares held in trust by the Whitehall Trust Ltd in England. The assessments raised by the Commissioner were against Levers, which was not a South African resident. It would, therefore, be clear that the Commissioner would not be able to control the interest paid to Levers since these amounts did not go through South Africa. Overseas Holdings as a South African resident company would, however, be liable for tax assessments in South Africa but would have had no income out of which the tax could be paid and no access to capital to do so. Accordingly, under the principle of effectiveness, the Commissioner would likely not be able to tax the income in question.

An application of the Kergeulen test clearly does not remove all doubt from the question of source of income in the *Lever Brothers* case. It is plausible that, had the judges approached the facts on this basis, there would nevertheless have been a split decision. The key distinction between an approach based on practicality and one based on the principles of the Kergeulen test is that the latter approach promotes the development of a comprehensive and definitive understanding of when income will be subject to taxation in South Africa while the former does not. It is through the rigorous examination of a principled approach that succeeding cases can refine our understanding of these issues. Over time, through the application of judicial precedent, legal certainty in these matters can be enhanced. It is for this reason that a philosophical approach to determining source of income is argued for; it will not make the so-called “hard cases” any less challenging to judges, but it will promote a systemic approach to law that, through constant examination and revision, will achieve a greater understanding of source of income than a flexible approach predicated on common sense and practical convenience.

5.5. CONCLUSION

The practical approach to determining source of income arose out of a literalist/intentionalist approach to statutory interpretation. Accordingly, source of income was held to be practical question not out of convenience but as a result of the intention of the legislature. With the advent of constitutionalism, however, new theories of statutory interpretation have found favour. One of the more prominent of these is the purposive approach, which, for the present purposes, allows the source of income enquiry to be disentangled from practicality, if this would better serve the legislative purpose.

It was then shown that a philosophical approach to probing complex social issues has two distinct advantages over practical approaches. In the first case, by approaching problems systematically and analytically, the philosophical approach makes it possible to find a definitive test for source of income. In the second case, even if no such test is possible, the philosophical approach is a humbling endeavour; that better equips the judicial decision-maker to the task of judging than mere deference to "common sense."

On the basis that a philosophical method is preferred, it was then argued that the principled approach taken in the *Kergeulen* case creates a two-legged test that can provide definitive answers to source of income questions. What the *Kergeulen* case did was to break down the source of income enquiry into its two constituent principles: that taxation must be equitable and that it must be effective. By applying this test to the facts of *Lever Brothers* it became clear that such an approach would not make questions of source of income easy. Instead, what it does achieve is the creation of a mechanism that works in harmony with judicial precedent to continually refine the meaning of source of income with the contributions of successive judgments. This approach, therefore, has the capacity to achieve greater legal certainty over time where approaches predicated on practicality or common sense cannot.

CHAPTER 6: CONCLUSION

> *Lord Bacon reminds us that the thoughts of the philosophers may be likened to the stars, they are lofty, but give very little light.*
>
> – Stratford CJ, *Kergeulen*

6.1. INTRODUCTION

The aim of this research was to critically analyse the practical person principle with particular emphasis on its application in the *Lever Brothers* case. In the process of achieving this goal, a number of sub-goals were set out; these included evaluating the extent to which the practical person principle requires judges to adopt a criterion that is too flexible for legitimate judicial decision-making; assessing whether the practical person principle promotes legal certainty, the principle of judicial precedent and the rule of law; debating the extent to which the practical person principle creates a clash between a philosophical approach to law and an approach that is based on common sense or practicality; and considering whether adopting a philosophical approach to determining the source of income can overcome the problems associated with the practical approach.

This chapter will summarise the conclusions drawn in Chapters 2 to 5 with particular emphasis on highlighting how these contributed to achieving the research objectives. Throughout this process it will be necessary to highlight certain topics that were considered to be beyond the scope of this research and, therefore, were afforded limited treatment. In some cases these limitations present opportunities for interesting and useful research in the future; these will be discussed briefly where appropriate. The final section of this chapter will be a short discussion of the value of the present research as a metaphor for the treatment of future legal quandaries.

6.2. SUMMARY OF CONCLUSIONS

The practical person principle was brought into South African law in the *Lever Brothers* case. It was, therefore, necessary to undertake a thorough evaluation of this case in order to lay the groundwork for the critical analysis that followed. This evaluation was conducted in Chapter 2 and involved contextualising the judgment as well as a discussion of each of the individual judge's judgments. From this, two broad features of the judgment appeared. First, that the complex and unusual transactions that gave rise to the case provided fertile ground for a final delineation of the nature of source of income. This led to the creation of the two-step framework, as well as the adoption of the practical person principle, and the *Lever Brothers* case became the ultimate authority for determining source of income until legislative amendments took place in 1998. The second broad feature of the judgment was that certain tensions between the three judgments were revealed. In particular, these tensions were shown to have arisen out of three different interpretations of the practical person principle and resulted in manifestly different approaches to the case. This divergence provided a foundation for the evaluation of practical person principle as a criterion for determining the source of income.

The object of Chapter 3 was, accordingly, to evaluate the practical person principle in greater detail. The approach taken in this regard was to first assess the purpose for which the principle was introduced as a means to providing a comprehensive description of how the principle operates. This involved tracing the history of the principle to its inception in the *Nathan* case. A brief comparative analysis of the use of this principle in other jurisdictions, particularly in Hong Kong, Singapore and Australia, was also undertaken. Given that the primary purpose of this thesis was to critically evaluate the application of the practical person principle as it arose in the *Lever Brothers* case, it was beyond the present scope to conduct a thorough investigation into the nuances of how this principle developed in different jurisdictions. Nevertheless, from the analysis conducted, it appeared that the practical person principle was introduced, in all the jurisdictions studied, to overcome certain problems that were considered inherent to the source of income inquiry. Specifically, that it was considered impossible to develop a definitive test for determining source of

income. This problem manifested in a further guise in that an ultimate hierarchy of factors for determining source of income could not be established.

The solution to these problems was the adoption of a flexible tool that would facilitate a *practical* approach to the particular *facts* of each case in order to avert the possibility of unjust results. This tool was created in the form of the practical person principle. Given the role that the practical person principle was crafted to fulfil, it became possible to elucidate a number of "characteristics" of this hypothetical person. In particular, the practical person principle provides a flexible criterion that facilitates giving precedence to the substance of a matter over its form; disregarding technical legal rules; aligns the law with public perceptions; and provides a practical – rather than philosophical – approach to judicial decision-making. This analysis formed the necessary first step toward the achieving the goal of critically analysing the principle.

The critical analysis of the practical person principle was undertaken in Chapter 4. Principally, this involved a critique that was carried out on two levels. The first level of analysis focused on problems with the "practical person" in *practice* while the second level addressed deeper problems with such an approach in *principle*. The problems in practice can be described as problems that arise out of the particular way that the practical person principle was used in the *Lever Brothers* case. Specifically, that such an approach relies on an anthropomorphisation of underlying aspects of the source of income enquiry. By personifying the approach to determining source of income two problems arise. First, that it is impossible to provide an adequate description of the standard that is implied by such a personification, since to do so would fail to recognise the differences implicit in a heterogeneous society. Second, that the anthropomorphised approach combines analytically separate enquiries with the result that judges are left without adequate guidance when determining source of income. Consequentially, the true operation of the practical person principle is lost.

The first significant finding of Chapter 4 was, accordingly, that the practical person principle – as an anthropomorphisation of underlying aspects of the source of income enquiry – is a problematic tool for determining source of income. Since such problems arise out of the particular incantation of this principle, however, these problems can be removed by describing the principle differently. Looking at the true

operation of the principle, as a tool to restrain the overzealous application of the law, it is argued that the personification can be removed without negating the underlying operation of the principle.

The reasoning undertaken to overcome these problems with the practical person principle involved a comparison with the concept of the reasonable person from criminal law. A number of similarities between these principles were shown; however, it was beyond the scope of the present enquiry to undertake a comprehensive comparison. If further research shows that it would be inappropriate to generalise conclusions drawn in respect of the reasonable person to the practical person principle, some of the conclusions in this research may have to be revised.

The second level of analysis focused on the operation of a practical approach to determining source of income in principle. The problems associated with a practical approach are, therefore, independent of the guise that is given to the principle. This investigation involved describing two criticisms of the underlying operation of the practical person principle. The first is that a practical approach to determining source of income is unsuited to dealing with complex legal issues. In this regard it is argued that a number of aspects of the South African legal system are created through the operation of legal fiction or metaphor. These aspects are, therefore, unsuited to practical evaluation and if such an approach is taken the effect is to dilute the concept of practicality to such a degree that it can no longer perform the function for which it was introduced. The second critique of the practical approach is that it provides an unduly flexible criterion for judicial decision-making. In this regard, the flexibility required to overcome the problems inherent to the source of income enquiry proves to be a "double-edged sword" in that it leaves the approach open to judicial manipulation.

The notion that judges may use the flexibility afforded to them with negative results has not been subject to much research in South Africa. In this regard, there is considerable scope for future research, particularly quantitative research into the extent to which judges can be seen as independent, objective adjudicators. The research cited suggests that judges may not be as objective as the legal system is designed to accommodate. If future research shows, however, that judges are capable

of achieving a high level of objectivity – and in doing so overcoming their subconscious biases – then many of the conclusions of this paper may no longer be valid. In such a case, the present critique of the practical approach to determining source of income will probably not hold to the extent argued presently.

The flexibility inherent to the practical approach to determining source of income is principally responsible for a number of negative down-stream consequences. This analysis formed the crux of this research and involved an evaluation of many of the sub-goals. First, that the doctrine of judicial precedent is eroded to such a degree that judges are given carte blanche with the particular facts. Second, that – by requiring matters be determined on a case-by-case basis along with the flexibility and uncertainty associated with the practical approach to determining source of income – there is no way for people to be able to bring their actions in line with the law before judicial pronouncement. The effect of this is to undermine the principle that the law should be applied prospectively as well as the presumption that everyone has knowledge of the law. Third, the cumulative effect of the above is legal certainty is compromised. Finally, since the rule of law – a founding value of the South African Constitution – requires that the law must be general in nature, prospective, clear and stable, the effect of the practical approach to source of income is to undermine the rule of law and is, therefore, unconstitutional. Paradoxically, this may also mean undermining one of the very characteristics of the operation of the practical person principle, that being to facilitate bringing the law in line with public perceptions of it.

From this analysis, the second significant finding of Chapter 4 could be drawn. This was that the practical approach to determining source of income results in a number of negative down-stream consequences, the effect of which is a situation that is not only undesirable but also unconstitutional.

Having shown the negative consequences of a practical approach to determining source of income, Chapter 5 set out to evaluate the relative merits of a philosophical approach to considering complex questions. It is in Chapter 5, therefore, that the reaming sub-goals were addressed. Regarding the first sub-goal, it was argued that a philosophical approach to probing complex social issues has two distinct advantages over practical approaches. First, a philosophical approach makes it possible to come

to definitive conclusions whereas a practical approach can only stumble upon such an outcome. Second, that even if no such conclusion is possible, the philosophical approach is a humbling endeavour that better serves the judicial decision-maker than mere deference to "common sense."

Regarding the second sub-goal, having shown that a philosophical method is preferred, it was then argued that the principled approach taken in the *Kergeulen* case could provide definitive answers to questions of source of income. This approach was then applied to the facts of *Lever Brothers* where it was shown that such an approach provides a mechanism that overcomes the problems associated with the practical approach to determining source of income. It is, therefore, concluded that a philosophical approach to determining source of income has the capacity to provide a definitive test under which greater legal certainty can be achieved over time.

The discussion regarding the conflict between practical and philosophical approaches to difficult subjects is a vast and complex area of research, which for the present purposes had to be severely limited. As with many things the answer will rarely fall squarely on one side or the other, instead – as Stratford CJ reminds us in *Kergeulen* – a delicate balance must be struck between "theoretical enquiry" and the "balance of practical convenience."[263] In the present case it is argued that the practical approach to determining source of income does not strike this balance appropriately; it is, therefore, argued that a philosophical enquiry would be preferred. Achieving a desirable balance is, however, an intricate and involved question that future research may be able to deduce.

6.3. THE PRESENT RESEARCH AS A METAPHOR

Legislative amendments changing South Africa's system of taxation from a source-based system to one based on residence, as well as the codification of the source of certain categories of income, have greatly limited the number of cases that will require an evaluation of the *Lever Brothers* precedent. The practical person principle is, therefore, largely a relic of the past. The key purpose of this thesis is, therefore, not to facilitate the achievement of an ultimate test for the determination of the source of

[263] *Kergeulen Sealing and Whaling Co Ltd v CIR* 1939 AD 487 504.

income, but rather its value is as a metaphor for the approach to legal thinking more generally. By illustrating the flaws of a solely practical approach to judicial decision-making, this paper argues for a more rigorous philosophical approach to the law.

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