Post 4.

IN THE HIGH COURT OF SOUTH AFRICA

NATAL PROVINCIAL DIVISION

APPEAL CASE NO AR 425/06

In the matter between

GUD HOLDINGS (PTY) LIMITED **Appellant**

and

COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE **Respondent**

JUDGMENT

Hurt J

The Taxpayer (the Appellant in these proceedings) carries on business as a manufacturer and distributor of automotive parts. Its customers are, almost exclusively, wholesalers. The terms of its standard conditions of sale, directly relevant to the issues in this appeal, are as follow: -

"1. PRICE, PAYMENT AND INTEREST

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

1.2 Any credit facilities allowed by SELLER to PURCHASER shall be in the discretion of SELLER who may at any time terminate or curtail such facilities in respect of any goods not yet delivered. Unless SELLER has agreed or stipulated

otherwise, payment must be made not later than the 25th day (or earlier full business day) of the month following the month during which delivery takes place.

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

1.4 Interest shall accrue on any amount due to SELLER calculated from due date at 2% per month or prime overdraft rate (which may be proved by a certificate from SELLER's bank) whichever is the higher."

In an agreed statement of facts, formulated under the provisions of Rule 10 of the Rules of the Tax Court, promulgated in terms of section 107A of the Income Tax Act, No 58 of 1962 ("the Act"), the operation of the "discount scheme" reflected in the above clause is described as follows: -

"4. Appellant operates a discount scheme in respect of its sales to wholesalers. In terms of this scheme, the wholesaler is entitled to a settlement discount if the wholesaler makes payment in respect of each sale by the 25th day of the month following that in which the relevant invoice is issued by Appellant.

5. A wholesaler making prompt payment will pay the selling price less the settlement discount (i.e. the wholesaler deducts the settlement discount itself and pays the net amount only). A copy of an invoice issued by Appellant to a wholesaler is attached marked "B".

6. The settlement discount referred to in paragraph 4 is dealt with in terms of paragraph 1 of the Standard Conditions. The extent of the settlement discount granted is agreed, in advance, on a percentage basis with each wholesaler.

7. In its accounting records, Appellant raises provisions, against the gross selling price, in respect of each wholesaler's settlement discount ("the Provisions"). The raising of the Provisions has the effect that only the portion of the gross selling price remaining after deduction of the settlement discount is included in Appellant's income.
8. The Provisions will only be reversed if a wholesaler does not make payment by the 25th day of the month following that in which the relevant invoice is issued by Appellant.
9. Appellant, for all financial reporting purposes, records its income as the amount remaining after deduction of the Provisions."

It was agreed that for the three years, 2002, 2003 and 2004, the extent to which these "provisions" had to be reversed because customers had not paid by the date stipulated in clause 1.3 was only 1.52%, 0.22% and 0.01% respectively. In other words, for practical purposes all of the Taxpayer's customers take advantage of the reduced price offered in return for prompt payment. The Taxpayer's return of gross income for the tax year ended 30 June 2003 included an amount for income accrued, but not yet received, in keeping with the definition of "gross income" in section 1 of the Act. However, the amount reflected as accrued was stated to be the sales figures less the "prompt payment discount" offered in terms of standard condition 1.3. However, as a result of an integrated audit by SARS, the Taxpayer was issued with an additional assessment for the 2003 year, in which the declared gross income was increased by R4 371 015.00. This amount was the sum of the discounts for which the

Taxpayer had made provision and omitted from its accrued income as at 30 June 2003.

The Taxpayer objected to this revised assessment under the provisions of section 81 of the Act, but the Commissioner dismissed the objection and the Taxpayer consequently appealed to the Tax Court in terms of section 83. **Levinsohn J**, sitting with assessors, dismissed the Taxpayer's appeal. The Court *a quo* analysed the entries in an invoice and a statement which were annexed to the judgment. It was held that these documents demonstrated that a credit was only passed in favour of the customer at the time when payment was made. *Ergo*, so the Tax Court held, the amount which had accrued in favour of the Taxpayer as at the end of the tax year was the full amount of the unpaid purchase price and the Taxpayer would only be entitled to claim an adjustment, in those cases where payment was effected within the period stipulated in condition 1.3, in the following tax year. The Taxpayer appeals to this Court against the finding of the Court *a quo*.

Before us, **Mr Shaw** (for the Appellant/Taxpayer) and **Mr Stevens**, for the Commissioner, were *ad idem* that the central issue in the appeal concerned the question of precisely what had "accrued" to the Taxpayer as at midnight on 30 June 2003. **Mr Stevens** submitted that the Court *a*

quo had correctly decided that the Taxpayer's accrued income was the total income reflected on the invoices issued up to midnight on 30 June 2003 but not yet paid over to the Taxpayer by its customers. **Mr Shaw**'s argument was that, in respect of unpaid amounts, what had "accrued" to the Taxpayer was only the amount to which it would be entitled in the event of the debt being paid within the time prescribed in sub-clause 1.3. In this regard **Mr Shaw** referred us to the judgments in **Commission for Inland Revenue v People's Stores (Walvis Bay) (Pty) Ltd** 1990(2) SA 353 A at page 364 to 365; **Cactus Investments (Pty) Ltd v CIR** 1999(1) SA 315 (SCA) at page 319; and **ITC 645 (61 SATC 31)** and the cases referred to at page 35 of that report.

The *fons et origo* of judicial pronouncements on the meaning of the word "accrued" in tax legislation is the case of **Lategan v Commissioner for Inland Revenue** 1926 CPD 203 at pages 209 to 210. In that case, **Watermeyer J** emphasised that the concept of "gross income" was not confined to an amount of money but embraced every other form of property, including debts and rights of action. He said (*loc.cit.*)

> "So far as a debt is concerned which is payable in the future and not in the year of assessment, it might be difficult to hold that the cash amount of the debt has accrued to the taxpayer in the year of assessment. He has not become entitled to a right to claim payment of the debt in the year of assessment but he has acquired the right to claim payment of the debt in future. This right has

> vested in him, has accrued to him in the year of assessment, and it is a valuable right which he could turn into money if he wished to do so.
>
> According to what has been stated above, the value of this right must, in my opinion, be included in the taxpayer's gross income for taxation purposes."

Between the years of 1926 and 1990, there appears to have been some doubt as to the validity of the approach adopted by **Watermeyer J** in the **Lategan** case. But this doubt was laid to rest by the Appellate Division in the **People's Stores** case *supra*. **Hefer JA**, at pages 363 to 366, sketched the history of the debate but concluded that the reasoning of **Watermeyer J** in the passage which I have quoted above was irrefutable and he went on to reject, as invalid, the criticisms of the judgment by **Ingram: "The Law of Income Tax of South Africa"**.

I think that this is one of the fairly rare cases where the maxim "*plus valet quod agitur quam quod simulatione concipitur*" applies in favour of the Taxpayer and against the Commissioner. What is aimed at by the Taxpayer and its customer, alike, is that the customer will purchase the goods for the net price, after deducting the clause 1.3 discount. The prescription that this price must be paid within the stipulated time is an incentive, to the customer, to take advantage of the lower price. The customer only becomes indebted for the full invoice price if his payment

is tardy. Judged from this viewpoint the "settlement discount" referred to in clause 1.3, is not so much a "discount" as it is a penalty which will be added for late payment. From this viewpoint, also, the concept that an amount equivalent to the discount "accrues" to the Taxpayer for the purpose of determining the gross income is as illogical as saying that, where a contract of sale provides for the payment of interest if payment is made after a certain date, such interest "accrues" to the seller at the time of sale.

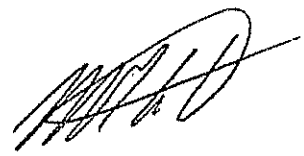
On the basis of the **Lategan** and **People's Stores** cases, the question is simply "What was the value of the Taxpayer's right at midnight on 30 June 2003?" Paraphrasing the words of **Watermeyer J**, if, at the close of the tax year, the Taxpayer had wanted to turn its rights to unpaid debts into money, what amount would it recover for them? I do not think that there can be any debate but that a Factor would only be prepared to pay the Taxpayer the selling price less the "discount" provided for in clause 1.3, for this would be all that the debtor was obliged, and would be likely, to pay. Based on this approach, it is, in my view, erroneous to suggest that the full invoiced price had accrued to the Taxpayer, as part of its gross income, at the close of the tax year.

I consider that the following order should be made:

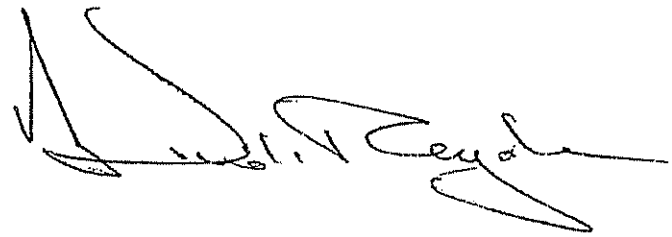
1. The appeal is allowed with costs.

2. There is substituted for the order of the Tax Court the following order:

   "The appeal is allowed and the assessment appealed against is set aside".



Van der Reyden J : I agree



Gyanda J : I agree

FOR THE APPELLANT	D J Shaw QC
INSTRUCTED BY	Garlicke & Bousfield
FOR THE RESPONDENT	G Stevens
INSTRUCTED BY	The State Attorney
DATE OF HEARING	30 January 2007
DATE OF JUDGMENT	16 February 2007