**DRAFT INTERPRETATION NOTE**

DATE:

**ACT : INCOME TAX ACT NO. 58 OF 1962 (the Act)**

**SECTIONS : SECTIONS 11(*a*), (*c*), 23(*c*) AND (*g*) AND SECTION 1(1), DEFINITION OF THE TERM "GROSS INCOME"**

**SUBJECT : DEDUCTIBILITY OF EXPENDITURE AND LOSSES ARISING FROM EMBEZZLEMENT OR THEFT OF MONEY**

***Preamble***

In this Note unless the context indicates otherwise –

- **"embezzlement"** means the misappropriation of funds entrusted to a person (for example, an employee or trustee) for care or management;
- **"section"** means a section of the Act;
- **"stolen money"** means money obtained from embezzlement or theft;
- **"Tax Administration Act"** means the Tax Administration Act No. 28 of 2011;
- **"theft"** means the act or crime of stealing money; and
- any word or expression bears the meaning ascribed to it in the Act.

## 1. Purpose

This Note provides guidance on –

- the deductibility of expenditure and losses incurred in a taxpayer's trade as a result of the embezzlement or theft of money, including expenditure incurred on legal and forensic services to investigate such losses; and
- the taxation of stolen money in the hands of the thief.

## 2. Background

Taxpayers may incur expenditure and losses during the course of their business activities as a result of embezzlement or theft of money by, for example, employees, directors, shareholders, partners, burglars or armed robbers. As a consequence, these taxpayers may also incur expenditure pertaining to legal and forensic services to investigate such losses.

The embezzlement or theft of money has income tax implications for both the victim and the thief.

## 3. The law

### Section 1(1) – Definition of the term "gross income"

**"gross income"**, in relation to any year or period of assessment, means—

(i) in the case of any resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such resident; or

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

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

. . .

### Section 11(*a*)

**11. General deductions allowed in determination of taxable income.**—For the purpose of determining the taxable income derived by any person from carrying on any trade, there shall be allowed as deductions from the income of such person so derived—

(*a*) expenditure and losses actually incurred in the production of the income, provided such expenditure and losses are not of a capital nature;

. . .

(*c*) any legal expenses (being fees for the services of legal practitioners, expenses incurred in procuring evidence or expert advice, court fees, witness fees and expenses, taxing fees, the fees and expenses of sheriffs or messengers of court and other expenses of litigation which are of an essentially similar nature to any of the said fees or expenses) actually incurred by the taxpayer during the year of assessment in respect of any claim, dispute or action at law arising in the course of or by reason of the ordinary operations undertaken by him in the carrying on of his trade: Provided that the amount to be allowed under this paragraph in respect of any such expenses shall be limited to so much thereof as—

(i) is not of a capital nature; and

(ii) is not incurred in respect of any claim made against the taxpayer for the payment of damages or compensation if by reason of the nature of the claim or the circumstances any payment which is or might be made in satisfaction or settlement of the claim does not or would not rank for deduction from his income under paragraph (a); and

(iii) is not incurred in respect of any claim made by the taxpayer for the payment to him of any amount which does not or would not constitute income of the taxpayer; and

(iv) is not incurred in respect of any dispute or action at law relating to any such claim as is referred to in paragraph (ii) or (iii) of this proviso;

### Section 23(*c*) and (*g*)

**23. Deductions not allowed in determination of taxable income.**—No deductions shall in any case be made in respect of the following matters, namely—

. . .

> (*c*) any loss or expense, the deduction of which would otherwise be allowable, to the extent to which it is recoverable under any contract of insurance, guarantee, security or indemnity;
>
> . . .
>
> (*g*) any moneys, claimed as a deduction from income derived from trade, to the extent to which such moneys were not laid out or expended for the purposes of trade;

## 4. Application of the law

### 4.1 The positive test [section 11(*a*)]

The general deduction formula consists of a positive test [section 11(*a*)] and a negative test [section 23(*g*)]. These two sections must be read together in order to determine whether a taxpayer will be entitled to a general deduction.

In determining a person's taxable income derived from carrying on any trade, section 11(*a*) provides a deduction for –

- expenditure and losses,
- actually incurred,
- in the production of the income,
- which are not of a capital nature.

In accordance with the opening words of section 11, any expenditure and losses from embezzlement or theft must also have been incurred in carrying on a trade. This trade requirement is also addressed by section 23(*g*) – see **4.2**.

In addition, expenditure and losses must be claimed during the year of assessment in which they are actually incurred – see **4.1.5**.

The facts and circumstances of each case must be considered when applying the principles discussed in this Note.

#### 4.1.1 Expenditure and losses

The words "expenditure" and "losses" referred to in section 11(*a*) are not defined in the Act.[1] In *Joffe & Co (Pty) Ltd v CIR* Watermeyer CJ explained the distinction between the words "loss" and "expenditure" as follows:[2]

> "In relation to trading operations the word [loss] is sometimes used to signify a deprivation suffered by the loser, usually an involuntary deprivation, whereas expenditure usually means a voluntary payment of money."

---

[1] *Collins Essential English Dictionary* (Collins Publishers 1989) defines "expenditure" as "the total amount of money that is spent on something" and "loss" as "the fact of no longer having something or of having less of it than you had before".

[2] 1946 AD 157, 13 SATC 354 at 360.

A similar distinction was drawn between "disbursements" or "expenses" on the one hand and "losses" on the other in the English case of *Allen (HM Inspector of Taxes) v Farquharson Brothers and Co,* in which Findlay J explained that the word "disbursements" –[3]

> "means something or other which the trader pays out; I think some sort of volition is indicated. He chooses to pay out some disbursement; it is an expense; it is something which comes out of his pocket. A loss is something different. That is not a thing which he expends or disburses. That is a thing which, so to speak, comes upon him *ab extra*".

In *COT v Rendle* Beadle CJ distinguished designed and fortuitous expenditure as follows:[4]

> "For the purposes of this case, expenditure incurred for the purpose of trade may be grouped broadly under two heads. First, money voluntarily and designedly spent by the taxpayer for the purpose of his trade; and second, money which is what I might call involuntarily spent because of some mischance or misfortune which has overtaken the taxpayer. For the sake of convenience, I will refer to the first type of expenditure as 'designed expenditure', and to the second as 'fortuitous expenditure'."

Other court cases have expressed similar views on the meaning of expenditure.[5]

Applying these principles to stolen money, the term "loss" would cover the embezzlement or theft of a taxpayer's own money, while the term "expenditure" would be more appropriate in describing a reimbursement of trust monies which have been stolen.

### 4.1.2 Actually incurred

For an expense or a loss to be deductible, it must be actually incurred. "Actually incurred" means that the taxpayer must have a definite and absolute liability to pay an amount. A liability that is conditional or contingent in any way, even if the condition or contingency is of a resolutive rather than a suspensive nature, will not be deductible.[6] Expenditure and losses that are uncertain, expected or which may arise in future are not considered "actually incurred" and are not deductible.[7]

### 4.1.3 In the production of the income

Expenditure and losses must have been incurred in the production of income in order to be deductible. The meaning of the words "in the production of the income" was considered by Watermeyer AJP (as he then was) in *Port Elizabeth Electric Tramway Company v CIR* in which he stated the following:[8]

> "The other question is, what attendant expenses can be deducted? How closely must they be linked to the business operation? Here, in my opinion, all expenses attached to the performance of a business operation *bona fide* performed for the purpose of earning income are deductible whether such expenses are necessary for its performance or attached to it by chance or are *bona fide* incurred for the more

---

3 17 TC 59 at 64.

4 1965 (1) SA 59 (SRAD), 26 SATC 326 at 329.

5 ITC 1783 (2004) 66 SATC 373 (G); *C: SARS v Labat Africa Ltd* [2012] 1 All SA 613 (SCA), 74 SATC 1; *Ackermans Ltd v C: SARS* 2011 (1) SA 1 (SCA), 73 SATC 1.

6 *NasionalePersBpk v KBI* 1986 (3) SA 549 (A), 48 SATC 55.

7 *Pyott Ltd v CIR* 1945 AD 128, 13 SATC 121; ITC 969 (1961) 24 SATC 777 (SW) and ITC 1545 (1992) 54 SATC 464 (C).

8 1936 CPD 241, 8 SATC 13 at 17.

> efficient performance of such operation provided they are so closely connected with it that they may be regarded as part of the cost of performing it."

Although this case dealt with expenses, the same principle applies to losses. This test was, with slight alteration in the wording, subsequently approved and applied by the Supreme Court of Appeal in a number of cases.[9]

In *COT v Rendle*[10] the taxpayer was a partner in a firm of Chartered Accountants which had collected certain monies from the sale of some properties on behalf of its clients. One of the clerks employed by the firm had embezzled the clients' funds, and the taxpayer had incurred expenditure in reimbursing the clients as well as in investigating the embezzlement and in obtaining legal advice. The taxpayer sought to claim a deduction for the expenditure. It was held that the amounts were allowable as they were part of the cost of performing the taxpayer's business operations. The court re-confirmed that the test established in the *Port Elizabeth Electric Tramway Co* case[11] was the appropriate test to apply when determining whether the expenditure and losses arising from the embezzlement or theft of money was incurred by the taxpayer in the production of the income and noted the following:[12]

> "All expenses attached to the performance of a business operation *bona fide* performed for the purpose of earning income are deductible whether such expenses are necessary for its performance or attached to it by chance or are *bona fide* incurred for the more efficient performance of such operation provided they are so closely connected with it that it would be proper, natural or reasonable to regard the expenses as part of the cost of performing the operation."

In deciding whether the fortuitous expenditure was deductible, the court in the *Rendle* case was of the opinion that the inquiry must be whether the "chance" of such expenditure or loss being incurred is sufficiently closely connected with the business operation. The focus is thus on the risk of the expenditure or loss being incurred and not on the actual expenditure or loss itself. The court summarised the legal position as follows:[13]

> "Before fortuitious expenditure can be deducted, the taxpayer must show that the risk of the mishap which gives rise to the expenditure happening, must be inseparable from or a necessary incident of the carrying on of the particular business."

The test as formulated above has been confirmed and applied in various other court cases.[14]

---

[9] *CIR v Genn & Co* 1955 (3) SA 293 (A), 20 SATC 113*, CIR v African Oxygen Ltd* 1963 (1) SA 681 (A), 25 SATC 67and *CIR v Allied Building Society* 1963 (4) SA 1 (A), 25 SATC 343.

[10] Above*.*

[11] As subsequently modified by various Appellate Division decisions

[12] At SATC 330.

[13] At SATC 333.

[14] ITC 1221 (1974) 36 SATC 233 (R); ITC 1242 (1975) 37 SATC 306 (C); ITC 1268 (1977) 40 SATC 57 (T); ITC 1383 (1978) 46 SATC 90 (T) and ITC 1710 (1999) 63 SATC 403 (C).

In ITC 952[15] the appellant, a practising attorney, had carried on business in partnership. The appellant's partner had stolen money from the partnership trust account which the appellant had made good. At issue was whether the amount paid by the appellant was an allowable deduction for income tax purposes. In finding that the amount was not allowable, Fieldsend P stated that –[16]

> "the essential factor to be determined is whether the dishonest removal of funds was a reasonably incidental risk to the production of assessable income in the locality at the time".

Although the language used in the *Rendle* case ("inseparable from" and "necessary incident of") differs from that used in ITC 952 ("reasonably incidental risk"), it is SARS's view that they are in substance the same test. The assessment which needs to be made is whether in the particular taxpayer's type of business the risk of embezzlement or theft is such a familiar and recognizable hazard so as to be considered inseparable from and inherent in the business.[17] In other words, when carrying on that type of business the taxpayer inevitably has to undertake the risk that theft or embezzlement could occur.

In ITC 1383[18] the appellant, a commercial bank, had claimed a deduction for a loss incurred as a result of theft by an employee. The "fairly senior" employee ranked sixth amongst the bank's senior officials at its head office but only had control over three employees. In allowing the loss as a deduction Hill AJ found that the risk of loss to a bank as a result of theft was an ever-present factor, stating the following:[19]

> "The appellant in the present case is a commercial bank which in the ordinary course of its business must necessarily allow the employees to handle large sums of money and however careful it could be expected to be in the selection and supervision of its staff, the risk of theft is an ever-present factor in the administration of its business and must be regarded as inseparable from it."

Burglary and robbery are likewise inherent risks attached to conducting a business and losses arising therefrom are connected with the trade.[20]

The removal of the proceeds from cash sales from a business by a sole proprietor is not theft but rather represents an omission of income.

The application of the risk test in the context of embezzlement or theft committed by senior employees or officials can be more difficult. The court cases have tended to find that such expenditure and losses are not deductible.

In *Lockie Bros Ltd v CIR*[21] a manager of the South African branch of a United Kingdom company had stolen a large sum of money from the company and the appellant sought to claim the loss as a deduction for income tax purposes. Mason J found that the loss was not incurred in the production of income because the embezzlement of the funds was not an operation undertaken for the purposes of the business.

---

[15] (1961) 24 SATC 547 (F).
[16] At 551.
[17] See the *Rendle* case above at SATC 333.
[18] (1978) 46 SATC 90 (T).
[19] At 94/95.
[20] ITC 1268 (1977) 40 SATC 57 (T).
[21] 1922 TPD 42, 32 SATC 150.

In ITC 952 above, the court stated that a sound reason for the decision in the Lockie Bros case was –[22]

> "that one does not reasonably expect a senior manager or managing director to make away with his employer's funds, and that such a risk is not reasonably incidental to the trade, as the petty larcenies of servants and the leakages through carelessness or dishonesty to which the revenues of most profit-earning organizations are exposed".

Turning to the facts of ITC 952 (that is theft by a partner of the appellant), Fieldsend J held as follows:[23]

> "Applying the law to the facts of the appellant's case I do not think that it can be said that the defalcations of a partner in an attorney's firm can be said to be the kind of casualty, mischance or misfortune which is a natural and recognized incident of the business. If a distinction is to be drawn between ordinary servants, and managers or managing directors, for which there appears to be authority, it seems to me that, *a fortiori*,[24] a partner is in quite a different position to an ordinary servant. For this reason alone it seems to me that the appeal in this case cannot be allowed."

In ITC 1383, the commercial bank case referred to above, Hill AJ, referred to overseas court cases and authors when discussing the proposition that if a loss is occasioned by a theft committed by an employee it may be deductible, but if it is committed by a proprietor (including a partner, managing director or someone with the powers to represent his employer at that level) a deduction would not be permitted. He noted that in his view the position would be the same in South Africa under the Act. The loss was held to be deductible. On the facts of the case it is clear that the employee's "fairly senior position" was not similar to that of proprietorship.

There is a view that times have changed since the *Lockie Bros* case and that embezzlement and theft by senior managers may have become a risk which is inseparable from business. SARS is, however, not prepared to accept this view as a general proposition. Each case must be considered on its merits having regard to its particular facts. Taxpayers incurring expenditure and losses at the hands of senior managers will need to be able to provide evidence that in their type of business the risk of senior managers embezzling or stealing is an incidental risk of the business.

In ITC 1661[25] the appellants were two dentists who practised in partnership. They appointed a firm of auditors to perform certain management and accounting functions which included the making out of and signing of cheques on behalf of the partnership. One of the auditors' employees and possibly one of the auditors had stolen money and falsified signatures on cheques or used cheques for their own purposes. At issue was whether the losses could be claimed as a deduction under section 11(*a*). The court held that the losses were not allowable because the auditors and their employee were independent contractors and there was no evidence to prove that theft by an independent contractor was an inherent risk of the practice of dentistry. The court noted that for the losses to be deductible the theft would have to be a kind of misfortune which was a material or recognised incident of the partnership, but this was not the case in the present matter.

---

[22] At SATC 551.
[23] At 552.
[24] For a still stronger reason.
[25] (1998) 61 SATC 353 (G).

By contrast, in *X v COT*[26] the High Court, Southern Rhodesia held that a loss incurred by a partner in a firm of attorneys as a result of the theft by an independent contractor of a client's funds was allowable. The attorney had negligently delivered municipal stock certificates to a stockbroker in negotiable form. The stockbroker had disposed of the stock and misappropriated the client's funds. The court found that the loss had been incurred in the course of the taxpayer's operations which were directed to the production of income. The negligence of the attorney was not a bar to the deduction of the loss since the risk of such a loss was an ever-present one in an attorney's practice.

### 4.1.4 Not of a capital nature

In order for an expense or loss to be deductible it must not be of a capital nature. The capital or revenue nature of an expense or loss will be determined by the facts of the particular case. The courts have developed a number of tests for distinguishing between capital and revenue expenditure. These tests are discussed in Chapter 2 of the *Comprehensive Guide to CGT* (Issue 4) which is available on the SARS website. A useful test for distinguishing capital and revenue expenditure is the distinction between fixed and floating capital. In *CIR v George Forest Timber Co Ltd* Innes CJ stated the following:[27]

> "Capital, it should be remembered, might be either fixed or floating. The substantial difference was that floating capital was consumed and disappeared in the very process of production, while fixed capital did not; though it produced fresh wealth it remained intact. The distinction was relative, for even fixed capital, such as machinery, did gradually wear away and required to be renewed."

In the *Lockie Bros* case cited in **4.1.3** Mason J did not find it necessary to decide whether the loss resulting from embezzlement by a manager was of a capital nature, although he stated that there was much to be said for that view. De Waal J held that the loss was of a capital nature on the basis that once the company's assets are converted into money it becomes portion of its capital for reinvestment, if so desired. De Waal J's view, that the loss was of a capital nature, is not regarded as correctly reflecting the law as it is not in line with the fixed versus floating capital distinction drawn in the *George Forest Timber* case.

The theft of cash from a bank results in a loss of a revenue nature because it represents a loss of floating capital.[28] Likewise, the theft of money from a bank account, petty cash, safe or payroll employed in a non-banking business also represents a loss of floating capital and will give rise to a loss of a revenue nature.[29]

The theft of notes and coins in current circulation cannot give rise to a capital loss because the definition of an "asset" in paragraph 1 of the Eighth Schedule excludes currency other than any coin made mainly from gold or platinum. However, if the thief can be identified the person whose currency has been stolen may well acquire a claim against the thief with a base cost equal to the amount stolen. A capital loss may result assuming that the amount is not deductible against

---

[26] 1960 (2) SA 682 (SR), 23 SATC 297.
[27] 1924 AD 516, 1 SATC 20 at 23.
[28] ITC 1383 (1978) 46 SATC 90 at 93.
[29] See ITC 1242 (1975) 37 SATC 306 (C); ITC 1221 (1974) 36 SATC 233 (R) and ITC 1268 (1977) 40 SATC 57 (T).

income under section 11(*a*)[30] or disqualified under paragraph 56 of the Eighth Schedule if the thief was a connected person in relation to the taxpayer and the claim is not recoverable. The onus of proving the amount stolen and hence the expenditure on the claim rests on the taxpayer under section 102 of the Tax Administration Act.

The theft of an amount from a bank account is not a theft of cash but the loss of a debt claim against the bank. Again, if the thief can be identified the disposal of the whole or a portion of the bank account would be followed by the acquisition of a claim against the thief. The base cost of the claim against the thief would be the amount by which the taxpayer has been impoverished, namely, the amount misappropriated from the bank account.

#### 4.1.5 During the year of assessment

Expenditure and losses must be claimed in the year of assessment in which they were incurred.[31]

A revenue loss as a result of embezzlement or theft must be claimed in the year of assessment in which the embezzlement or theft occurs and not in the year of assessment in which it is discovered. Any amount so claimed under section 11(*a*) which is subsequently recovered from the embezzler or thief must be brought to account as a recoupment under section 8(4)(*a*) in the year of recovery.

Under section 99 of the Tax Administration Act a reduced assessment may not be issued after the elapse of three years from the date of the assessment. Thus it will not be possible to claim an expense or loss omitted from a return of income for a year of assessment once the original assessment for that year has become final.

Under paragraph 13(1)(*c*)(ii) of the Eighth Schedule a capital loss arising from an irrecoverable claim against a thief would occur on the later of the date on which the loss was discovered or the date on which it is established that no compensation will be payable (for example, on the date on which an insurer rejects the taxpayer's claim and the taxpayer accepts the repudiation).

### 4.2 The negative test [section 23(*g*)]

Section 23(*g*) denies a deduction for moneys claimed as a deduction from income derived from trade to the extent that the moneys are not laid out or expended for the purposes of trade. A taxpayer that meets the requirements of section 11(*a*) is likely to also meet the trade requirement. However, losses as a result of embezzlement or theft which are of a domestic or private nature will be denied as a deduction under section 23(*g*).

### 4.3 Expenditure on legal and forensic services

The cost of forensic services incurred to investigate embezzlement or theft will be deductible under section 11(*a*) if the expenditure and losses resulting from the embezzlement or theft are deductible under section 11(*a*). See *COT v Rendle*[32] in which the court held that the costs of investigation and legal advice were inextricably

---

[30] The base cost of the claim would be reduced to nil under paragraph 20(3)(*a*) of the Eighth Schedule since the expenditure on the claim would have been allowed under section 11(*a*).

[31] *Sub-Nigel Ltd v CIR* 1948 (4) SA 580 (A), 15 SATC 381 at 390 and ITC 1545 (1992) 54 SATC 464 (C) at 471.

[32] Above at SATC 336.

related to the embezzlements and were allowable as deductions on the same grounds.

Any claim for legal expenses in investigating the embezzlement or theft must be made under section 11(*c*), which requires that the legal expenses must –

- be actually incurred during the year of assessment;
- be in respect of any claim, dispute or action of law which arises in the course of or by reason of the ordinary operations undertaken by the taxpayer in the carrying on of the trade;
- not be of a capital nature;
- not relate to a claim against the taxpayer for damages or compensation which, if payable, would not qualify as a deduction under section 11(*a*);
- not relate to a claim by the taxpayer for an amount which would not comprise income of the taxpayer (assuming that the claim were successful); and
- not be incurred in respect of any dispute or action at law relating to any claim referred to in the preceding two bullet points (that is, which relates to non-deductible amounts or amounts not comprising income as the case may be).

Thus, for example, if an employee steals trust funds which the taxpayer is required to make good, any legal expenses incurred in relation to the theft of the funds would qualify as a deduction provided that the amount made good by the taxpayer qualifies as a deduction under section 11(*a*).[33]

### 4.4 Recoverable amounts [section 23(*c*)]

Any expenditure and losses, which would otherwise be allowed as deductions, that are recoverable under a contract of insurance, guarantee, security or indemnity will not be allowed as deductions under section 23(*c*).

### 4.5 Proof of embezzlement and theft of money

A taxpayer claiming a deduction for expenditure and losses owing to the embezzlement and theft of money and for expenditure pertaining to legal and forensic services to investigate such expenditure and losses bears the onus of proving such expenditure and losses under section 102 of the Tax Administration Act.

Without limiting the manner in which the expenditure and losses can be proven, the following will be considered as *prima facie* proof that such expenditure and losses occurred:

- A police case docket reference number;
- A report by an accredited private investigator;
- A report by a forensic auditor; or
- A charge sheet issued by a court.

A taxpayer will also need to prove the *quantum* of the expenditure and losses.

[33] In ITC 1710 (1999) 63 SATC 403 (C) the court allowed legal expenses as a deduction under section 11(*c*) because the damages to which they related qualified as a deduction under section 11(*a*).

### 4.6 Taxation of stolen money

A thief will be taxed on embezzled or stolen money if it falls within the thief's gross income.

The opening words of the definition of the term "gross income" in section 1(1) contain two key requirements relevant in the context of this Note for an amount to be included in gross income. They are that an amount must –

- be received by or accrued to a taxpayer, and
- not be of a capital nature.

#### 4.6.1 Received by or accrued to

The terms "received by" and "accrued to" are not defined in the Act, but they have been the subject of judicial interpretation.

In *Geldenhuys v CIR* Steyn J stated that the words "received by" as used in the definition of the term "gross income" –[34]

> "must mean 'received by the taxpayer on his own behalf for his own benefit' ".

The words "accrued to" were held by Watermeyer J (as he then was) in *WH Lategan v CIR* to mean –[35]

> "to which he has become entitled".

In the context of stolen money there can be no accrual because a thief is not unconditionally entitled to the money. There can, however, be a receipt – see below.

In 1918 the Transvaal Provincial Division confirmed in *CIR v Delagoa Bay Cigarette Co, Ltd* that income was taxable even if derived from an illegal source. In that case, which involved the sale of illegal lottery tickets together with packets of cigarettes, Bristowe J stated the following:[36]

> "I do not think it is material for the purpose of this case whether the business carried on by the company was legal or illegal. Excess profits duty, like income tax, is leviable on all incomes exceeding the specified minimum, and after making the prescribed calculations and deducting the exemptions, abatement and deductions enumerated in the statute. The source of the income is immaterial. This was so held in *Partridge v Mallandaine* (18 Q.B.D. 276), where the profits of a betting business was held to be taxable to income tax; Denman J. saying that 'even the fact of a vocation being unlawful could not be set up against the demand for income tax'."

In *COT v G*[37] it was held that money stolen by a thief was not 'received' by him within the meaning of the Zimbabwean Tax Act as a thief "takes" rather than "receives" the money. As will be seen below, this decision is not regarded as correctly reflecting the position under South African law.

---

[34] 1947 (3) SA 256 (C),14 SATC 419 at 430.

[35] 1926 CPD 203, 2 SATC 16 at 20. The correctness of the interpretation of "accrued to" in *Lategan's* case was subsequently confirmed by Hefer JA in *CIR v People's Stores (Walvis Bay) (Pty) Ltd* 1990 (2) SA 353 (A), 52 SATC 9 at 24.

[36] 1918 TPD 391, 32 SATC 47 at 49.

[37] 1981 (4) SA 167 (ZA), 43 SATC 159.

In ITC 1545[38] the appellant had been taxed on the proceeds from the sale of stolen diamonds and the receipts from the growing and sale of dried "milk cultures". The latter activity was described by the court as a money-making racket similar to a chain-letter scheme and was accepted as amounting to an illegal lottery. The court held that the amounts were received by the taxpayer for the purposes of the definition of "gross income" notwithstanding that they were in pursuance of a void transaction. It distinguished the facts of the case from *G's* case above, noting that the instant case was not one in which there had been no receipt but merely a "taking" by a thief.

In ITC 1624[39] the appellant, acting as agent, fraudulently overcharged its principal for wharfage fees which it claimed it had paid to Portnet on the principal's behalf. The fraud was discovered in a later year of assessment and the appellant had refunded the overcharged amounts to its principal. The appellant argued that the amounts were not received by it as it was under an immediate obligation to repay them. Alternatively, the appellant argued that it was entitled to a deduction in the same year of assessment for the liability it had incurred to repay the amounts. The court rejected these arguments holding that the amounts were received by the appellant as part of its business receipts and that the amount was not an expenditure or loss incurred during the year of assessment in question. The court considered *G's* case above but declined to follow the *ratio* in that case.

In ITC 1792[40] the appellant, a stockbroker, had acted as agent for a principal on behalf of whom he bought and sold shares. The appellant, together with others, had become aware of the shares that his principal would be acquiring. He acquired those shares in a separate company and later sold them at a profit to his principal. The issue was whether the appellant was liable to tax on these illegal secret profits. The court found, based on the law of agency, that an agent is not entitled to make secret profits and that those profits belong to the principal. It accordingly held that the amounts had not been received by the appellant on his own behalf for his own benefit. Based on the outcome of the *MP Finance* case below, it is considered that this case was not correctly decided. The issue is not the legal relationship between principal and agent but between the agent and the *fiscus*.

The Supreme Court of Appeal case of *MP Finance Group CC (in liquidation) v C: SARS*[41] considered the question of whether deposits taken in an illegal and fraudulent pyramid scheme constituted amounts "received" within the meaning of "gross income". The taxpayer argued that because the scheme was liable in law to return the deposits there was no basis on which it could be said that they were "received" within the meaning of the Act. The court rejected this argument, stating the following:[42]

> "An illegal contract is not without all legal consequences; it can, indeed, have fiscal consequences.[5] The sole question as between scheme and *fiscus* is whether the amounts paid to the scheme in the tax years in issue came within the literal meaning of the Act.[6] Unquestionably they did. They were accepted by the operators of the scheme with the intention of retaining them for their own benefit. Notwithstanding that in law they were immediately repayable, they constituted receipts within the meaning of the Act."

[38] (1992) 54 SATC 464 (C).
[39] (1996) 59 SATC 373 (T).
[40] (2005) 67 SATC 236 (G).
[41] 2007 (5) SA 521 (SCA), 69 SATC 141.
[42] At SATC 145.

[5] *Commissioner for Inland Revenue v Insolvent Estate Botha* 1990 (2) SA 548 (A) at 556C–557B; 52 SATC 47.

[6] *Ibid* at 557I–558A; 52 SATC at 58.

The principle to be drawn from the above cases is that the receipt of stolen money comprises gross income and is thus taxable.

### 4.6.2 Not of a capital nature

The question has been raised whether stolen monies derived from a one-off opportunistic and fortuitous theft could be of a capital nature, as opposed to a considered and well-planned illegal business operation which is of a revenue nature.[43]

The case of *CIR v Pick 'n Pay Employee Share Purchase Trust*[44] is authority for the principle that the receipts or accruals bear the imprint of revenue if they are not fortuitous but designedly sought for and worked for. An opportunistic theft can hardly be described as "fortuitous". It is designedly sought and requires intent, planning and execution. It is therefore considered improbable that an amount derived from a once-off theft can be of a capital nature.

## 5 Conclusion

Expenditure and losses incurred by a taxpayer in carrying on a trade as a result of embezzlement or theft of money and any legal and forensic expenditure incurred in investigating the crime will qualify as a deduction in determining taxable income provided it meets the requirements of section 11(*a*) or in the case of legal expenses, section 11(*c*). An important factor in determining the deductibility of the expense or loss will be whether the risk of its incurral was a necessary incident of the taxpayer's trade.

A person who derives funds illegally, whether by embezzlement or theft, is regarded as having "received" those funds for the purposes of the definition of the term "gross income" in section 1(1) and will be subject to income tax on those funds.

**Legal and Policy Division**
**SOUTH AFRICAN REVENUE SERVICE**

[43] George Goldswain "Illegal Activities" (2008) 22 *Tax Planning* 143.
[44] 1992 (4) SA 39 (A), 54 SATC 271 at 280.