SUB-NIGEL LTD v COMMISSIONER FOR INLAND REVENUE 15 SATC 381

Division: Appellate

Judges: CENTLIVRES AND GREENBERG JJA AND HOEXTER AJA

Date: 14 September and 6 October 1948

Also cited as: 1948 (4) SA 580(A)

Income Tax − Gold Mining Company − Payment of premiums to insure against loss of profits and cost of standing charges during suspension of operations owing to fire − Whether expenditure admissible as deductions in determination of taxable income − Sections 11(2) (a), 12(g) and 20, Act 31 of 1941 − Section 2, Act 25 of 1940.

Appeal on a case stated directly to the Appellate Division by the Special Court for hearing Income Tax Appeals, in terms of section 81(b) of Act 31 of 1941, as amended.

The appellant company, which carried on the business of mining for gold, had made a practice of taking out policies of insurance against loss incurred by fire in respect of net profits and standing charges.

The insurance against the loss of net profits was undertaken in order to enable the company to maintain a steady rate of dividend to its shareholders, notwithstanding a cessation of operations in part or in whole by reason of fire; the insurance in respect of standing charges was designed to enable the company to carry on its essential services without loss, notwithstanding any such cessation of mining operations.

The taking out of such policies was a regular practice of the group of companies of which the appellant company was one.

During the year of assessment under review no claim was made by the company under these policies.

In respect of the year of assessment ended the 30th June, 1946, the company sought to deduct−

(a) in the determination of its taxable income derived from activities other than the mining for gold, the premium of £1,565 paid by it in respect of this insurance against loss of net profits;

(b) in the determination of its normal taxable income derived from mining for gold, the premium of £1,102 paid by it in respect of insurance against loss incurred by meeting the cost of standing charges during any interruption caused by fire to the production of gold;

and in respect of the year of assessment ended on 31st December, 1945,

(c) in the determination of its taxable profits derived from mining for gold for the purpose of the Gold Mines Special Contribution levied under Act 25 of 1940, an amount of £1,055 paid by it as premium for that period in respect of insurance against loss incurred in respect of standing charges.

The Commissioner for Inland Revenue having disallowed these deductions, the company appealed against his decision to the Special Court for hearing Income Tax Appeals, which dismissed the company's appeal and confirmed the Commissioner's assessments, holding that the amounts were not wholly and exclusively laid out and expended for the purposes of the company's trade and were consequently forbidden as deductions by section 12(g) of the Income Tax Act, No 31 of 1941.

The company, being dissatisfied with this determination as being erroneous in law, required the Special Court to state a case for appeal to the Appellate Division of the Supreme Court.

Held, allowing the appeal with costs, and ordering the assessments made to be set aside and fresh assessments to be made according to the principles laid down in the judgment, that the expenditure upon premiums was incurred for the purpose of earning income in the event of certain happenings and was not of a capital nature;

Held, further, that any amount received under the policies would constitute a trading receipt and consequently the expenditure on the premiums had been laid out or expended for the purposes of the Company's trade;

Held, further, that the provisions of section 20 of Act No 31 of 1941, which include under capital expenditure ranking for redemption in the case of mining operations expenditure incurred in general administration and management during any period of non-production, did not effect the nature of the expenditure incurred to provide a set-off against that expenditure;

Held, accordingly, that the expenditure on the premiums of the policies concerned was admissible expenditure in terms of section 11(2)(a) of the Income Tax Act and was not debarred from allowance by the terms of section 12(g) of that Act.

J.V. Brink, K.C. (with him *W.A. Currie*) for the appellant:

The Special Court's judgment means that the premiums in question were payments for capital account and any amounts that might be recovered would also be for capital account; in this connection the provision of sec 12(c) of Act 31 of 1941 is to be noted. The implication from this section is that both premiums and amounts recovered are for revenue account. The insurance against loss of profits and of standing charges is part of the trade of mining, being a regularly recurring prudent and normal business operation

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incidental to and closely connected with the mining operations; and any sums recovered under the policies would be receipts of the trade and would be assessable income. The facts of *Rex v British Columbia Fir and Cedar Lumber Co., Ltd*. (1932, A.C. 441) show how the converse case was dealt with; it followed from that decision that the premiums were also for revenue account. See the *Thomas Merthyr* case (1933, 1 K.B. 349 at pp. 368, 375, 376). The fact that the premium in the *British Columbia Fir and Cedar case(supra*) had in the ordinary course been brought into the account of the Company as a revenue charge was used in the judgment as a reason for holding that the money recovered from the insurance company was also a revenue matter (see p. 447); this was a matter of vital importance in a particular year, e.g. to non-cumulative preference stock-holders. This case followed *Gliksten & Son v Green* (1929, A.C. 381) and was followed in *C.I.R. v Williams' Executor* (1943 (1), A.E.R. at pp. 318, 321). The premiums paid annually are expenditure incurred in the business operation to produce income should certain events transpire, they are for revenue account because they are directed solely towards the production of income in that event; they do not result in the building up of any enduring asset of a capital nature; if no fire occurs, the premiums are expended for good and nothing remains; if no fire occurs, the premiums are expended for good and nothing remains; if a fire occurs the money recovered is also expended, either upon payment of standing charges or in dividends to shareholders; *Rhymney Iron Co., Ltd. v Fowler* (1896, 2 Q.B.D. 79) and the *Thomas Merthyr* case(*supra*) are distinguishable in that in these cases the Court came to the conclusion on the special facts of those cases that the sums that would be recovered would be receipts quite apart from the trade of the taxpayer and that for that reason they were not deductible expenditure. But the insurance in the present case is for loss of profits and not for payment when no trade is being carried on; further, in the present case, no capital receipts are contemplated by appellant from the insurance in question and therefore the *Rhymney* case(*supra*) has no application at all; cf. *Thomas Merthyr* case (*supra*, at pp. 370, 371, 374-5). The present case falls into line with cases like *Thomas v Richard Evans & Co*. (1927 (1), K.B. 33); *Ensign Shipping Company's* case (12 T. C. at pp. 1169, 1179); and *Murphy v Gray & Co*. (1940, (3), A.E.R. 214). The broad test to be applied in every case in order to ascertain whether expenditure is for capital or revenue account is

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laid down in *New State Areas v C.I.R*. (1946, A.D. 610 at p. 627).1

As to the submission that the nature of the expenditure depends on the purpose for which it is made, regardless of the results of the expenditure, see the test laid down in *New State Areas v C.I.R*. (*supra*, at p. 627); *Morley v Lawford & Co*. (1928, L.T. 125); *Sydney Ferries, Ltd. v Commissioner of Taxes* (1891-1927, Australian I.T. Decisions, p. 169); *Neville & Co. v Commissioner of Taxes* (1937, 4 Australian I.T. Decisions, pp. 187, 193). There is nothing in any of the judgments to support the proposition that unless a profit is shown actually to result from expenditure, such expenditure cannot be said to have been incurred in the production of income or for the purposes of trade. As to the submission that in all the circumstances the premiums are expenditure incurred wholly and exclusively for the purpose of appellant's trade, see definition of "trade" in sec 7 of the Act and *cf*. the definitions of "income" in *Rex v B.C. Fir & Cedar Co.* (*supra*, at pp. 448, 451). Even a single transaction may constitute a trade. The question as to whether annual insurance premiums paid to insure loss of capital assets should be allowed as a deductible expense, although not falling to be decided in the present case, affords an illustration of what is regarded as expenditure reasonably incidental to the conduct of trade and so closely connected therewith as to answer the test propounded in *Port Elizabeth Tramway Company v C.I.R*. (8 SATC at p. 17). If the main capital assets are destroyed by fire the business may have to close down for good; there is, therefore, a direct *nexus* between the continuation of the trade and the expenditure; *cf. Usher's Wiltshire Brewery Ltd. v Bruce* (1915, A.C. at pp. 433, 447, 457). Insurance against loss in connection with standing charges is a much stronger case because no capital asset is restored to existence by the insurance money received; this aspect was not even argued in *Rex v B.C. Fir & C. Co*. (*supra*), at p. 450), though it arose.

B.A. Ettlinger, K.C. (with him *A. Fischer*), for the respondent: In order to determine the "taxable income" derived by any person from carrying on any trade, a start is made from his "income" as defined in sec 7 of the Income Tax Act, and then such deductions or set-off are made as are allowed by secs 11 and 12 of the Act. The premium payments could be allowed as deductions from appellant's income only if they were actually incurred in the production

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of the income and were not of a capital nature, and they were wholly or exclusively expended for the purposes of appellant's trade; *cf*. secs 11(2)(a) and 12(g); the premium payments claimed by appellant as deductions do not comply with either of these conditions. In regard to sec 11(2)(a), the expenditure was not incurred in gaining or producing income; *cf. W. Neville & Co., Ltd. v F.C.T*. (*supra*), at pp. 187, 193); it was made to protect appellant from the contingency of ceasing to earn income and being involved in unproductive expenditure; *cf. C.I.R. v Thompson* (1935, TPD 166).2 There is no relation whatever between the expenditure and the income from which it is sought to be deducted; *cf. Amalgamated Zinc Ltd. v F.C.T*. (1935, 3 Aus. Tax Decisions, at pp. 288, 293, 295, 297); *McCusker v C.I.R*. (1947 (3), S.A.L.R. at pp. 190, 200);3 and whether the premiums were paid or not, appellant would have earned the same income. The expenditure in question was not part of the cost of performing the income-producing operations; *cf. Port Elizabeth Electric Tramways, Ltd. v C.I.R*. (1936, C.P.D. 241 at pp. 244-6); *New State Areas, Ltd. v C.I.R*. (1946, A.D. 610 at p. 627); furthermore, the expenditure, even in so far as it may be said to be directed towards the obtaining of income, was directed towards the obtaining, in a particular contingency, of income of an entirely different character from the income from the appellant's business of gold mining, that is, "non-mining" income as an alternative to "mining" income. "The income" in sec 11(2)(a) is not something which may, or may not, be paid to the taxpayer by way of indemnity for loss of income; the expenditure was made to prevent the possible extinction of appellant's business; *cf. Ward v Collector of Taxes* (1923, A.C. 148); *African Greyhound Racing Association, Ltd. v C.I.R*. (1945, TPD 344).4 In any event the premiums were spent with a view to acquiring a source of revenue in a certain contingency, and were therefore payments of a capital nature; *cf. C.I.R. v George Forest Timber Co., Ltd*. (1924, A.D. at pp. 516, 525);5 *New State Areas, Ltd. v C.I.R.* (*supra*, at pp. 620-1); and in so far as the standing charges are concerned expenditure on such charges during a period of non-production would be "capital expenditure" under sec 20(10), ranking for redemption under secs 11(2)(f) and 20. It follows that any recoupment of such charges, whether by way of insurance or otherwise, would not be gross income under sec 7, but would be

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set off against the actual expenditure incurred, and the premium for the insurance of the standing charges could, therefore, be an allowable deduction; see secs 12(f) and 7(f). In regard to sec 12(g) of the Act, the foregoing arguments in regard to sec 11(2)(a) also show that the expenditure was not wholly or exclusively expended for the purpose of trade; *cf. Port Elizabeth Electric Tramways, Ltd. v C.I.R.* (*supra*); *Joffe & Co. v C.I.R.* (1946, A.D. at pp. 157, 163).6 The expenditure was incurred in order to obtain something in the contingency of there being a cessation of trade, not from trade being carried on; *cf. Thomas Merthyr Colliery, Ltd. v Davis* (1933 (1), K.B. 349); *Rhymney Iron Co., Ltd. v Fowler* (1896 (2), Q.B. 79). "For the purposes of trade" means for the purpose of enabling the taxpayer to carry on the trade and to earn income therefrom; it is not sufficient that expenditure should be made in the course of, or arise out of, or be connected with the trade or be made out of the profits of the trade; *cf. Strong & Co. v Woodifield* (1906, A.C. 448 at pp. 452-3); *Union Coal Storage Ltd. v Jones* (8 T.C. at pp. 740-1). Though money expended, not of necessity but voluntarily and on grounds of commercial expediency, may be deductible, it can only be deducted if the expenditure was made in order to facilitate "the carrying on of the business"; *cf. British Insulated Cables & Helsby Ltd. v Atherton* (1926, A.C. at pp. 205, 212). The fact that the proceeds of the policies, if a fire had occurred, might have been part of appellant's gross income, does not prove that the premium payments for the policies are, in the computation of appellant's taxable income, deductible from appellant's income in a year in which no fire occurred; this point never arose for decision, and was not decided, in either *Rex v British Columbia Fir Co., Ltd*. (*supra*), or *J. Gliksten & Son, Ltd. v Green* (*supra*). Moreover, *Rex v British Columbia Fir Co., Ltd*., was decided on the particular definition of "Income" in the British Columbia Taxation Act. It is not correct to say that appellant, in taking out the policies, was engaged in a "trade" apart from its other trades.

Brink, K.C., in reply.

Cur. adv. vult.

Postea (October 6th).

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CENTLIVRES JA: This is an appeal on a case stated by the Special Income Tax Court, the parties having duly lodged their written consents, in terms of sec 81(b) of Act 31 of 1941 as amended, to the appeal being heard by this Court without an intermediate appeal to a Provincial or Local Division.

It appears from the stated case that the appellant company, to which I shall refer as the Company, for many years carried on the business of mining for gold in the Transvaal and that it was its practice to take out policies of insurance against loss occasioned by fire of nett profits and standing charges. The stated case gives the following reasons for taking out such policies of insurance:–

"(a) *Nett profits*: Because the company considers it prudent policy to provide that in the event of a cessation of mining operations, the capacity to make a steady return by way of dividend to shareholders should be maintained.

(b) *Standing charges*: In the event of a cessation of operations it would still be necessary for the company to continue essential services and to maintain the requisite plant and equipment, such as pumping plants, sewerage plants, electric power plant and system of water mains, and for these purposes it is bound to retain sufficient European and Native personnel for the administration and maintenance thereof. The Native labour force is engaged on contract in terms whereof the said force is housed and paid. The dispersal and repatriation of the said force would entail great difficulty and heavy expense in reinstating it on the resumption of operations. The conditions under which gold mining is carried on are such that fire always constitutes a considerable hazard. An appreciable cessation of mining operations would entail very considerable standing charges, the failure to insure against which would seriously impair the company's finances, and a stoppage over a long period might result in the permanent closing down of the mine owing to lack of funds to recommence operations.

(c) The companies comprising the group, namely, The New Consolidated Gold Fields Limited, and including the Company, have always taken out policies insuring against loss of profits and standing charges in the ordinary course of business because in the opinion of the company the taking out of such policies are necessary and prudent steps in the conduct of their operations.

(d) Because, according to the understanding of the public

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> officer of the company, this practice is one adopted by substantially all producing gold mining companies, members of the Transvaal Chamber of Mines."

It was not, however, proved to the satisfaction of the Income Tax Special Court that the practice referred to in the concluding paragraph of the above quotation was in fact adopted by all gold producing mining companies which are members of the Transvaal Chamber of Mines.

No claim was made by the Company on its insurer under the policies taken out by it against loss occasioned by fire of nett profits and standing charges.

For the year of assessment ending on June 30th, 1946, the Company sought to deduct−

(a) in the determination of its normal taxable income derived from activities other than mining in the Union for gold an amount of £1,565 paid by it as a premium under a policy of insurance against loss of nett profits occasioned by fire;

(b) in the determination of its normal taxable income derived from mining in the Union for gold an amount of £1,102 paid by it as a premium under a policy of insurance against loss of standing charges during a period when production of gold might be interrupted on account of destruction of plant by fire.

For the year of assessment ending on December 31st, 1945, the Company sought to deduct in the determination of its taxable profit derived from mining for gold for the purpose of the gold mines special contribution (levied under sec 2 of Act 25 of 1940) an amount of £1,055 paid by it as a premium under policies of insurance against loss of standing charges. It will be noted that the Company drew a distinction between its income derived from mining and its other income. This distinction was drawn presumably because of the provisions of sec 3(1) (a) of Act 25 of 1940 and of sec 1(1)(v) of Act 39 of 1945. The Commissioner in his assessment of the Company for normal tax in respect of the year ending on June 30th, 1946, disallowed and added back the amounts of £1,565 and £1,102 referred to above, and in his assessment for the gold mines special contribution in respect of the year ending on December 31st, 1945, he disallowed and added back the amount of £1,055. The Company lodged an objection against the above assessments on the ground that the deductions it had made were permissible under sec 11(2)(a) of the Act.

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The issue before the Special Court was whether the Company was entitled under the Act to deduct these amounts. The Special Court held that these amounts were not wholly and exclusively laid out and expended for the purposes of the Company's trade and that consequently the deduction of those amounts was forbidden by sec 12(g) of Act 31 of 1941, to which I shall refer as the Act. That Court dismissed the appeal and confirmed the Commissioner's assessments. It is against that decision that the present appeal is brought.

At the outset it must be pointed out that the Court is not concerned with deductions which may be considered proper from an accountant's point of view or from the point of view of a prudent trader, but merely with the deductions which are permissible according to the language of the Act. See *Joffe & Co., Ltd. v Commissioner for Inland Revenue* (1946, A.D. 157 at p. 165).[7] In the present case it may be conceded that it would be in accordance with sound business principles for the Company to deduct the amount of the premiums paid by it in order to arrive at its nett profits. This consideration is, however, irrelevant: the only relevant matters in this case are the provisions of the Act which deal with permissible and non-permissible deductions. *cf. Pyott Ltd. v Commissioner for Inland Revenue* (1945, A.D. 128 at p. 135).[8]

Regard, therefore, must be had to the Act and the Act alone in order to ascertain whether the deductions sought to be made by the Company are permissible. For the purposes of this case I shall assume that the proper method of approach in enquiring whether a particular deduction is permissible is, firstly, to ascertain whether it is permissible under sec 11(2)(a) and then to find out whether it is prohibited by sec 12(g) − a method of approach which does not seem to have been applied previously in this Court. *Cf. Joffe & Co., Ltd. v Commissioner for Inland Revenue*(*supra*) and *New State Areas Ltd. v Commissioner for Inland Revenue* (1946, A.D. 610).[9] There is much to be said for the view that the two sections must be read together, for the general rule is that a statute must be construed as a whole; it is, however, not necessary in this case to express any view on this point. Sec 11(2)(a) of the Act provides that for the purpose of determining the taxable income derived by any person carrying on any trade within the Union, the deductions allowed shall be

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> "expenditure and losses actually incurred in the Union in the production of the income, provided such expenditure and losses are not of a capital nature."

In the present case it is common cause that the amounts paid by way of premiums were actually expended in the Union, and therefore the first questions that arise are whether the expenditure was incurred "in the production of the income" and whether the expenditure was or was not of a capital nature.

It was contended by Mr *Ettlinger* on behalf of the Commissioner that stress should be laid on the definite article "the" before the word "income" in sec 11(2)(a) and that as the expenditure of the amounts by way of premiums produced no income, such expenditure was not incurred in the production of *the* income and was therefore not deductible. Pressed to its logical conclusion this contention means that if a merchant were to buy goods for the purpose of re-sale and pay for them on the last day of the tax year, and were to sell none of these goods before the end of the tax year, he would not be able to deduct the purchase price of those goods from his gross income for that year because the expenditure, although incurred in that year, produced no income in that year. That this is not so is shown by such cases as *Commissioner for Inland Revenue v Niko* (1940, A.D. 416, at p. 427),10 for it is clear that the merchant, in determining his taxable income, is entitled to deduct from the proceeds of any re-sales effected by him the purchase price of goods which he has not resold during the tax year. Indeed, if Mr *Ettlinger's* argument were correct, the merchant would not be allowed, in the example I have given, to deduct the purchase price of the goods bought at the end of the tax year from his gross income for that year, nor would he be able to deduct it in respect of the following tax year, although he may have disposed of all the goods during the latter year. For the whole scheme of the Act shows that, as the taxpayer is assessed for income tax for a period of one year, no expenditure incurred in a year previous to the particular tax year can be deducted. It is true that under sec 11(3) there may be set off any balance of assessed loss incurred by a taxpayer in any previous year which has been carried forward from the preceding year of assessment but such assessed loss is not arrived at by deduction from the gross income earned during the year of assessment expenditure incurred in a previous year; such

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expenditure having already been deducted in the year in which it was incurred. If Mr *Ettlinger's* contention were correct it would also follow that if a merchant opened his business to the public on the first day of the tax year, having stocked his premises prior to that date, he would never be able to bring into account the price he paid for the goods. The Legislature could never have intended such an absurd result. The correct position would be that the merchant would show in his accounts for the year prior to the opening of his premises to the public the expenditure incurred during that year in purchasing his stock; that expenditure would be carried forward into the next year as an assessed loss under sec 11(3) but it would not be deductible in respect of the later year as an expenditure under sec 11(2)(a).

I am fortified in the view I have expressed above by a decision of the Full Bench of the Australian High Court in *Amalgamated Zinc* (*de Bavay's*) *Ltd. v F.C.T*. (3, A.T.C. at p. 297). The Australian Income Tax Assessment Act 1922-1930 provided in sec 23(1)(a) that

> "in calculating the taxable income of a taxpayer, the total assessable income derived by the taxpayer shall be taken as a basis and from it there shall be deducted all losses and outgoings . . . actually incurred in gaining or producing the assessable income."

This provision is similar to sec 11(2)(a) of our Act DIXON, J., in the case cited said:–

> "Sec 23(1)(a) does not authorize a deduction of outgoings unless incurred in gaining or producing the assessable income. A very wide application should be given the expression 'incurred in gaining or producing the assessable income.' But the words refer to the assessable income from which the deduction is to be made. In a continuing business, items of expenditure are commonly treated as belonging to the accounting period in which they are met. It is not the practice to institute an enquiry into the exact time at which it is hoped that expenditure made within the accounting period will have an effect upon the production of assessable income, and to refuse to allow it as a deduction if that time is found to lie beyond the period. And, in the case of expenditure for which the taxpayer contracted a liability during an earlier accounting period than that in which it has

> matured, it is not the practice to consider whether its

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> effect upon the production of income of a still continuing undertaking has already been exhausted. The terms of sec 23(1)(a) have never been understood as requiring such a thing, see *Ward & Co. v Commissioner of Taxes and Herald and Weekly Times Ltd. v Federal Commissioner of Taxation* (48 C.L.R., at 118; 2 A.T.D., 169)."

I have not been able to find any authority in support of Mr *Ettlinger's* contention other than(possibly) *Joffe & Co., Ltd. v Commissioner for Inland Revenue* (1946, A.D. 157).11 WATERMEYER, C.J., in dealing with sec 11(2)(a), said, at p. 163:–

> "Attention should be directed to the definite article 'the'. 'The income' referred to here is, of course, the income as defined by sec 7 of the Act, that is the gross income less any amounts exempt from normal tax, and the gross income is the total amount received or accrued to the appellant in the period of assessment. The damages which were paid are, therefore, only deductible if they constitute expenditure not of a capital nature which was incurred in producing the income in respect of which the tax was levied. Sec 12(g) which, in the case of income derived from trade, prohibits the deductions of any moneys 'which are not wholly or exclusively expended for the purposes of trade', makes it clear that such expenditure, in order to be deductible must not only be connected with the production of income but must have been paid out for the purposes of trade."

At first sight the third sentence in the above quotation seems to support Mr *Ettlinger's* contention, but it is clear from a perusal of the whole case (see p. 167) that the *ratio decidendi* was that sec 12(g) prohibited the deduction which the taxpayer sought to make. The emphasis placed on the definite article "the" was *obiter*, and in any event the learned CHIEF JUSTICE did not lay down that non-capital expenditure could not be deducted if no income resulted therefrom in the year in which it was incurred. Nor was he, in the passage I have quoted, attempting to construe the phrase "expenditure and losses incurred in the production of the income." He dealt with that phrase in *Port Elizabeth Electric Tramway Co. v Commissioner for Inland Revenue* (1936, C.P.D. 241 at p. 243)12 when he said:

> "Bearing in mind that the words 'income' and 'trade' are defined in the Act, the first problem which presents itself is to

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> construe the phrase 'expenditure and losses incurred in the production of income'. Gross income (that is receipts and accruals) is not produced directly by either expenditure or losses. It results from work and labour or the use of capital in productive enterprise or the loan of capital, and it is produced in divers ways. As a very rough generalisation it may be said that, save in the case of loan of capital, income is produced by a series of operations and transactions entered into for the purpose of manufacturing or acquiring a saleable product and thereafter selling it or by rendering services for which payment is received. In the course of such operations and transactions expenditure and losses may be incurred, and these are the expenditure and losses referred to in the section . . .";

and at p. 245:

> "Businesses are conducted by different persons in different ways. The purpose of the act entailing expenditure must be looked to. If it is performed for the purpose of earning income then the expenditure attendant upon it is deductible"

provided, of course, such expenditure is not of a capital nature.

Much the same view as the above had been previously expressed by MASON, J., in *Lockie Bros. Ltd. v Commissioner for Inland Revenue* (1922, TPD 42 at p. 44) where he said:

> "The first question is as to the meaning of the words 'in the production of income'; patently they cannot be taken in their literal sense, because a loss cannot produce income, and because, if the whole year's business resulted in a loss, not even the outgoings could be said to be incurred in the production of a non-existent income, yet by sub-sec(2) of this section" (now sub-sec(3) of sec 11) "the loss on a year's business is to be assessed and may be deducted in subsequent years. The usual meaning which I think an ordinary person would attach to these words in connection with a business is that deductions are to be allowed for any losses or outgoings actually incurred in the

> course of and by reason of the ordinary operations undertaken for the purpose of conducting the business, not being losses or outgoings of a capital nature."

I must also point out that the reasoning in *Port Elizabeth Electric Tramway Co., Ltd. v Commissioner for Inland Revenue*(*supra*) was referred to with evident approval in *New State Areas Ltd. v Commissioner for Inland Revenue* (*supra*, at p. 620).

The conclusion at which I arrive on this part of the case is that

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there is no reason to think that the Legislature, in using the definite article "the" before "income" in sec 11(2)(a), intended the result contended for by Mr *Ettlinger*. It seems to me clear on the authorities that the Court is not concerned whether a particular item of expenditure produced any part of *the* income: what it is concerned with is whether that item of expenditure was incurred for the purpose of earning income. The reason why the Legislature used the definite article "the" before "income" in sec 11(2)(a) is probably because it had previously used it in the immediately preceding sub-section.

The whole *raison d'etre* of the Company is to earn profits, and in taking out these policies it was endeavouring to maintain its profits by making provision against loss in the event of a fire. Now, was the act entailing the expenditure of the amounts paid by way of premium performed for the purpose of earning income? In my opinion the answer to this question is in the affirmative. The mere fact that no income has actually resulted is, in my view, irrelevant: the purpose was to obtain income on the happening of a fire which would prevent the carrying on of income-producing operations. There can, to my mind, be no doubt that, if a fire had occurred, the proceeds paid by the Company's insurer in respect of the policies ensuring nett profits would have been of a non-capital nature and would therefore have had to be included in the Company's "gross income" as defined by sec 7 of the Act. See *Rex v B.C. Fir and Cedar Lumber Co., Ltd*. (1932, A.C. 441). Even apart from the above authority, it is difficult to understand how such proceeds could be regarded as receipts of a capital nature within the meaning of "gross income" as defined in sec 7. Similarly it seems to me that the proceeds of the policies in respect of the standing charges would also be of a non-capital nature and, but for the provisions of sec 12(c) of the Act, would have had to be included in the Company's gross income. That section provides that no deduction shall be made in respect of

> "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."

For the purposes of the Act it would seem, therefore, that if the Company had recovered £x in respect of standing charges under its policies and that if the standing charges had been £x plus y it could deduct only £y, but exactly the same result would be arrived

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at if £x were included in its gross income and £x plus y were deducted. If, which is of course unlikely, the Company recovered £x plus y from its insurer and its actual standing charges were £x, £y would constitute portion of its gross income. To adapt the language used by the Privy Council in *Rex v B.C. Fir and Cedar Lumber Co., Ltd.* (*supra*, at p. 450) the effect of complying with sec 12(c) (the account being otherwise in credit) would necessarily be to increase by the amount of the moneys received from the insurer the taxable income of the Company. Moreover the words "expense the deduction of which would otherwise be allowable" in sec 12(c) obviously include those expenses which may be deducted under sec 11(2)(a). Such expenses are those of a non-capital nature and are ordinarily paid out of revenue and it is in keeping with the view that the proceeds from an insurance policy in respect of standing charges should, being receipts of a non-capital nature, be set off against expenditure actually incurred which is of a non-capital nature. In any event, for reasons which I shall give later, the fact that the Legislature requires that certain moneys should be dealt with in a particular manner does not show that those moneys are of a capital nature.

The next question which arises is whether the expenditure of the moneys paid by way of premium was or was not of a capital nature. The difficulty of determining in particular cases when an expenditure is or is not of a capital nature is illustrated by the numerous cases quoted by WATERMEYER, C.J., in *New State Areas Ltd. v Commissioner for Inland Revenue*(*supra*). After quoting from and considering those cases the learned CHIEF JUSTICE said, on p. 627:

> "The conclusion to be drawn from all of these cases seems to be that the true nature of each transaction must be enquired into in order to determine whether the expenditure attached to it is capital or revenue expenditure. Its true nature is a matter of fact and the purpose of the

> expenditure is an important factor; if it is incurred for the purpose of acquiring a capital asset for the business it is capital expenditure, even if it is paid in annual instalments; if, on the other hand, it is in truth no more than part of the cost incidental to the performance of the income-producing operations, as distinguished from the equipment of the income-producing machine, then it is revenue expenditure, even if it is paid in a lump sum."

When the learned CHIEF JUSTICE said that if expenditure is incurred

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for the purpose of acquiring a capital asset for the business it is capital expenditure, he had, I think, in mind the following passage from the judgment of INNES, C.J., in *Commissioner for Inland Revenue v George Forest Timber Co., Ltd*. (1924, A.D. 516 at p. 526)13, which he quoted at p. 621"

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

In considering whether expenditure is of a capital or non-capital nature it is well to bear in mind that it does not necessarily follow that because expenditure produces income or is intended to produce income or is intended to produce income on the happening of a certain event, such expenditure is of a non-capital nature, for, as INNES, C.J., said in the case abovementioned, at p. 527,

> "Capital may be so spent as to come back in the form of income within the meaning of the statute. Money invested in an annuity is an example."

The converse may possibly be true, e.g., moneys spent by way of premiums to insure capital assets against fire may constitute expenditure of a non-capital nature, although the proceeds of any such fire policy would be receipts of a capital nature. This seems to be the view held in England. See *Usher's Wiltshire Brewery, Ltd. v Bruce* (1914 (1) K.B. 357 at p. 367; 1915, A.C. 453 at pp. 457, 465, 471, 474). On this point I express no opinion.

It is, in my view, impossible to give a definition of what is expenditure of a non-capital nature which will act as a touchstone in deciding all possible cases and it would be impracticable to attempt such a definition. When the Company paid its premiums on its policies in respect of net profits and standing charges, it acquired a right of action against the insurer to recover moneys in terms of the policies on a fire breaking out which would prevent it from carrying on its mining operations. This right of action constituted an asset, but it was not a capital asset in the sense used by

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WATERMEYER, C.J., in the *New State Areas* case nor a source of profit which will yield recurring income in the sense used by INNES, C.J., in the *George Forest Timber* case. As the premiums form part of the cost incidental to the performance of income-producing operations they are, in the words of WATERMEYER, C.J., revenue expenditure. I come to the conclusion, therefore, that the amounts paid by way of premiums are not amounts of a capital nature and that they constitute permissible deductions under sec 11(2)(a). I shall deal later with Mr *Ettlinger's* contention that, in view of sec 20 of the Act, the premiums paid under the policies in respect of standing charges cannot be deducted under sec 11(2)(a).

The further question arises whether sec 12(g) prohibits the deduction of the amounts paid by way of premium. That section provides that no deduction shall in any case be made in respect of

> "any moneys, claimed as a deduction from income derived from trade, which are not wholly or exclusively laid out or expended for the purposes of trade."

This provision is for practical purposes the same as the provision in the English Income Tax Acts which prohibits the deduction of

> "any disbursements or expenses whatever, not being money wholly and exclusively laid out or expended for the purposes of such trade."

The Special Court, in holding that the deductions were prohibited by sec 12(g), relied on *Rhymney Iron Company, Ltd. v Fowler* (1896 (2) Q.B.D. 79), the approval of the *ratio decidendi* in that case by the Transvaal Provincial Division in *Commissioner for Inland Revenue v Thompson* (1935, TPD 166 at p. 171)14 and *Thomas Merthyr Colliery Co., Ltd. v Davis* (1933 (1) K.B. 349).

The English cases require careful consideration. In *Rhymney Iron Co. v Fowler*(*supra*) the taxpayer was a subscriber to a coal-owners' association which indemnified its subscribers against losses occasioned by strikes. The agreement between the taxpayer and the association provided that

> "a member shall be paid an indemnity on any deficiency of actual daily output, up to and not in excess of the tonnage assured, to be calculated upon an average of the actual output per day."

It was held that the relevant provision in the English statute prohibited

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a deduction of the subscription to the association. After quoting that provision POLLOCK, B., said, on pp. 83, 84.

> "it seems to me, without adding to these words, it would be sufficient to say that this is not money laid out for the purposes of such trade; it is money laid out in order to provide for an unfortunate contingency, by reason whereof the trade cannot be worked. That is a very different thing."

This reasoning places a very narrow interpretation on the words of the statute and in later English decisions a wider meaning has been given to the words "for the purposes of such trade". For instance in *Thomas v Richard Evans & Co., Ltd*. (1927 (1) K.B. 33) it was held by the Court of Appeal that premiums paid to a mutual association to indemnify members in respect of workmen's compensation were deductible. The *Rhymney* case, it is true, was not quoted in argument nor referred to in the judgments, but the decision seems to me to be inconsistent with the *ratio decidendi* in the earlier case. I may add, in parenthesis, that in *Port Elizabeth Electric Tramway Co. v Commissioner for Inland Revenue*(*supra*) it was held that compensation payable under the Workmen's Compensation Act was a permissible deduction: *a fortiori* one would think that a premium paid to cover such compensation would be deductible.

In the later English case of *Thomas Merthyr Colliery Co., Ltd. v Davis*(*supra*), where the taxpayer was a subscriber to the same coal-owners' association as figured in the *Rhymney* case, that case was followed, but it is evident from a perusal of all the judgments in that case that the judges had misgivings about the correctness of the earlier case. FINLAY, J., the judge of first instance, said at p. 359 that he was impressed by the argument that the principles which were enunciated in later cases show that the principle upon which the *Rhymney* case was based could not be correct but that, as the *Rhymney* case had stood not disapproved for many years, he would not be justified in departing from that case. It is instructive to quote the following passages from the judgments delivered on appeal. Lord HANWORTH, M.R., at p. 368, said that if the money to be received from the association

> "is money which is to be deemed an ordinary trading receipt, it would seem by parity of reasoning that the money expended on the premium would be a deductible sum in carrying on the ordinary business of the company. We have not got to decide that, but I agree with what ROMER, L.J., said in the course of

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> the argument, that there is a close connection between a payment for the purpose of being reimbursed in certain events and the sum received, as in the *Gliksten* case (1929, A.C. 381), so that there will be a right to deduct from profits a sum paid for premium in order to ensure the receipt of money which, when received, will be a trading receipt."

SLESSER, L.J., said, at p. 375:

> "I agree, however, with the contention of Mr *Needham*, though I do not think it is necessary to decide it here, that it would be very difficult to argue successfully that, if the gains accruing from this indemnity were taxable profits, the premium which was paid for the purpose of earning those profits was not itself a disbursement or expense to be taken into account in computing the amount of the profit or gain to be charged."

ROMER, L.J., said, at p. 376:

> "In my opinion, any sums received by the appellants for the purposes of indemnifying them against loss of profits occasioned by a cessation or restriction of output would not be a trading receipt, and for that reason I have come to the conclusion that the part of the subscription paid by the appellants to the Association which may be deemed to have been paid for the purpose of securing such a benefit is not a sum of money that has been 'wholly and exclusively laid out or expended for the purpose of their trade'. It is not money that has been expended for the purpose of earning the appellant's profits."

It will be noted that both LORD HANWORTH, M.R., and ROMER, L.J., seem to have taken the view that sums of money received by taxpayers for the purpose of indemnifying them against loss of profits would not be a trading receipt and would, therefore, not be subject to income tax. It is difficult to reconcile this view with the decision of the Court of Appeal in *C.I.R. v Williams' Executors* (1943 (1) A. E.R. 318). I shall assume, however, that this is the position under the English Income Tax Act, but that Act differs from ours in many material respects, and more especially in that the English statute does not contain such an all-embracing definition as in our Act of "gross income". If moneys received by the Company in terms of its policies in respect of nett profits and standing charges must be regarded as being of a capital nature then it would follow that the premiums paid would not be deductible, but, as I have already held, such moneys do not constitute

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receipts of a capital nature. Consequently it seems to me that the principles laid down by these two English cases are not applicable under our law.

I may add that the decision of the Privy Council in *Rex v B.C. Fir and Cedar Lumber Co., Ltd.* (*supra*) is instructive and in accordance with the views which I have attempted to express. That was an appeal from the Supreme Court of Canada. The Canadian Act contained a wide definition of income. According to that definition the word "income" includes the

> "gross income earned, derived, received or accrued from any source whatever, the product of capital, labour, industry or skill . . . or from any venture, business or profession of any kind whatsoever."

It was held by the Privy Council that moneys received by manufacturers under the policies insuring them in respect of loss of nett profits that would have accrued had there been no interruption of business caused by fire is income from a business. On p. 447 of the report Lord BLANESBOROUGH said:

> "This insurance receipt therefore was the product of a revenue payment prudently made by the respondents to secure that the gains which might have been expected to accrue to them had there been no fire should not be lost, but should be replaced by a sum equivalent to their estimated amount."

When the learned Lord used the word "prudently" he did not, in my view, intend to suggest that the prudence or imprudence of a payment was relevant to the enquiry: he was merely stating that the payment was in fact made prudently. From the above passage it is clear that their Lordships regarded the amount paid by way of premium as a revenue payment: although this was, in the circumstances, an *obiter dictum*, it is nevertheless instructive.

To illustrate what I have already said about the difference between our Act and the English Act and the consequent danger of applying English decisions, I shall make one more quotation from *Thomas Merthyr Colliery Co. v Davis*(*supra*). At p. 372 SLESSER, L.J., said:–

> "It has been held in *Rex v B.C. Fir and Cedar Lumber Co.*, a case decided in the Privy Council, upon a British Columbia taxation Act containing language very different from the Income Tax Acts, that it might be, at any rate under the provisions of that Act, that where insurance is in respect of loss of nett profits

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> the amount received under the insurance policy would be taxable income, with the result presumably that the premiums paid therefor would be deductible expenses, though that matter was not expressly decided."

Before leaving this aspect of the case I must refer to a contention advanced by Mr *Ettlinger* that the expenditure by way of premiums in respect of standing charges was made to prevent the possible extinction of the Company's business and was therefore not deductible. He referred to the following statement made in the stated case:

> "An appreciable cessation of mining operations would entail very considerable standing charges, the failure to insure against which would seriously impair the Company's finances, and a stoppage over a long period might result in the permanent closing down owing to lack of funds required to recommence operations."

For this contention he relied on the cases of *Ward v Commissioner of Taxes* (1923, A.C. 148) and *African Greyhound Racing Association, Ltd. v Commissioner for Inland Revenue* (1945, TPD 344).15 In the former case it appeared that a poll of voters in New Zealand being about to be held under statutory authority on the question whether or not prohibition of intoxicants should be introduced, a brewery company expended money in printing and distributing anti-prohibition literature. The company sought to deduct the expenditure in the assessment of the income derived from their business. The relevant Act provided that no deduction was to be made in respect of expenditure "not exclusively incurred in the production of the assessable income". The Privy Council held that the deduction was not permissible.

In *African Greyhound Racing Association Ltd. v Commissioner for Inland Revenue*(*supra*) it was held that legal expenses incurred in connection with the taxpayer's representation before a commission to enquire into the question whether dog-racing should be abolished or its activities curtailed were not deductible.

These two cases have, in my opinion, no bearing upon the problem with which I am now concerned. It is clear that in both cases the purpose of the expenditure was not to earn income but, in the words of Viscount CAVE at p. 149 of the Privy Council case, to prevent

> "a step which would have depreciated and partly destroyed the profit-bearing thing."

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In other words the expenditure was incurred to preserve a capital asset and was therefore expenditure of a capital nature and not deductible. In the present case the position is different, for the expenditure in insuring in respect of standing charges which was incurred contemplated receiving moneys not of a capital nature on the occurrence of a fire, and as I have already pointed out, such receipts go to swell the taxable income of the Company. The expenditure in the Privy Council and Transvaal cases did not contemplate the receipt of any specific moneys from which it could have been deducted. In the present case, if a fire had occurred, there would have been a direct relation between the moneys received by the Company and the premiums paid.

The conclusion at which I arrive, therefore, is that sec 12(g) of the Act does not prohibit the deductions sought to be made by the Company.

Mr *Ettlinger* raised a further contention on the provisions of secs 7(f), 11(2)(f), 12(f) and 20 of the Act. He contended that, in so far as the standing charges are concerned, expenditure on such charges during a period of non-production would be "capital expenditure", under sec 20(10) of the Act, ranking for redemption under secs 11(2)(f) and 20 and that it followed that any recoupment of such charges, whether by insurance or otherwise, would not be gross income under sec 7 but would be set off against the actual expenditure incurred, and that the premium for the insurance of the standing charges could, therefore, not be an allowable deduction.

In order to understand this contention a number of sections of the Act must be mentioned. Under sec 11(2)(f) it is permissible to deduct

> "in respect of income from mining operations an amount to be ascertained under the provisions of sec *twenty*, in lieu of the allowance in paragraphs(d), (d)*bis*, (e) and(j) of this sub-section."

The allowance in para. (d) is an allowance in respect of the diminished value of machinery, etc., through wear and tear, (d)*bis*, an allowance in the circumstances there stated in respect of new machinery or plant, (e) a premium paid for the use or right of occupation of land or buildings, etc., and (j) an allowance in respect of scrapped machinery, etc. It may be assumed that all these items are, strictly speaking, capital expenditure, the deduction of which is specifically allowed by sec 11. *Cf. New State Areas v Commissioner*

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for Inland Revenue (*supra*, at p. 621). Under sec 20 the amount to be deducted is ascertained in the manner prescribed by sub-sec(1), from which it appears that a portion of the balance of capital expenditure, unredeemed at the commencement of the tax year, may be deducted. In sub-sec(10) "capital expenditure" is defined as meaning (I am quoting only that part of the definition which is relevant in this case)

> "expenditure on general administration and management during any period of non-production."

If I understand Mr *Ettlinger's* argument correctly, his contention is that any expenditure on general administration and management during a period of non-production would be capital expenditure and that payment made by way of premium to insure against such expenditure would be a payment made in order to receive a capital amount in the event of the contingency arising which is provided for in the policy. He sought to fortify this contention by referring to sec 7(f), which provides that

> "in the case of persons carrying on mining operations any amount by which recoupments from capital expenditure exceed the balance of capital expenditure ranking for redemption in terms of sec *twenty*"

shall be deemed to be included in gross income. As moneys received under a policy against loss of standing charges would be capital, it follows (so the argument proceeded) that the amount paid by way of premium would also be of a capital nature and therefore not deductible as expenditure. One must assume, for the purposes of Mr *Ettlinger's* argument, that standing charges are the same as "expenditure on general administration and management" within the meaning of the definition of "capital expenditure" in sec 20(10) of the Act. On this I express no opinion as there is no definition in the stated case of the words "standing charges"; although there is some indication that these words cover a somewhat wider field than expenditure on general administration and management. The answer, I think, to Mr *Ettlinger's* contention is that expenditure is defined as meaning

> "nett expenditure after taking into account any rebates, recoupments or returns from expenditure."

It seems to me that if a fire had occurred and the Company had received moneys from its insurer in respect of standing charges, those moneys would have had to be deducted from the gross capital

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expenditure in order to arrive at the nett capital expenditure. Here again (as in the application of sec 12 (a)) the effect of such a deduction is to reduce the deduction which might otherwise have been made under sec 20 and consequently to increase the taxable income of the Company. The mere fact that the Legislature may have enacted that moneys recovered under a policy in respect of standing charges must be deducted from "capital expenditure", as defined by it, cannot alter the character of such moneys. There is nothing to prevent the Legislature from enacting that portion of what is undoubtedly income should be deducted from capital expenditure under sec 20 but such enactment would not make that portion a receipt of a capital nature. I have already given my reasons for holding that moneys received from an insurer in respect of standing charges constitute receipts of a non-capital nature and in my view, on the assumption that all such moneys fall within the definition of "capital expenditure" in sec 20 and would have been deducted in terms of the definition of expenditure, it does not follow that such moneys are of a capital nature. As in my view they are of a non-capital nature, the expenditure incurred in producing such moneys would be expenditure of a non-capital nature and deductible under sec 11(2)(a). I am therefore of opinion that the provisions or sec 20 do not assist the Commissioner.

The result is that the appeal is allowed with costs, and, acting under the wide powers given to this Court under sec 81 of the Act as amended by sec 10 of Act 39 of 1945, the Court orders that the assessments made by the Commissioner be set aside and that he make fresh assessments according to the principles laid down in this judgment.

GREENBERG, J.A., and HOEXTER, A.J.A., concurred.

Footnotes