

TAX

The proper interpretation of conflicting provisions in the Income Tax Act

3 May 2023 8 min read

and Luke Magerman, Candidate Attorney

A recent tax court judgment added valuable jurisprudence to the often-litigated issue of the interpretation of two conflicting legislative provisions.

In the matter of *A v C:SARS* (Case No 46206), the taxpayer ceased her South African tax residence on 3 September 2017. Whilst resident, she was a member of a partnership, which owned a passenger aircraft and carried on a chartering business in the United Kingdom. For South African tax purposes, the partnership was tax transparent and not assessed as a separate taxpayer. Rather, each partner accounted for a portion of the partnership's income, expenses, allowances, etc in accordance with the partnership ratios.

The taxpayer accounted for her proportionate share of the partnership's income and claimed her proportionate share of the expenses of the air charter trade, as well as a proportionate share of the depreciation allowances available in respect of the aircraft. The result of her accounting for her portion of the partnership's income and deductions was that she accumulated an assessed loss in respect of the foreign charter business.

South African tax resident taxpayers are not eligible to set off against their South African source income any foreign trading losses. As a result, the taxpayer accumulated and carried forward to the 2018 tax year a substantial assessed foreign trade loss.

On 3 September 2017, the taxpayer permanently relocated to the UK and ceased to be a "resident" for South African tax purposes. This gave rise to certain automatic tax consequences, one being that the taxpayer was deemed to have disposed of her proportionate share of the aircraft business on the date immediately preceding the date on which she ceased to be resident. This deemed disposal triggered a recoupment in respect of depreciation allowances claimed on the aircraft in the foreign charter trading operation, which formed part of her accumulated, unutilised, foreign trade loss.

This recoupment was included in the taxpayer's income for the 2018 tax year, but she set off the accumulated foreign trading loss against this recoupment. SARS disallowed the set off in its entirety on the basis that the recoupment was, in terms of the legislation as it applied at the time, deemed to be South African source income against which an accumulated foreign trading loss could not be set off. The taxpayer objected to the dis-allowance of the set off and appealed to the Tax Court adjudicating over this matter.

ISSUE AND ARGUMENTS

The fundamental issue in dispute in the appeal was whether the taxpayer was entitled to set off the balance of the foreign assessed trading loss resulting from the foreign aircraft partnership trade against the recoupment triggered by the deemed disposal of her portion of the partnership's aircraft. The dispute turned on whether the source of the recoupment was South African or foreign.

SARS based its argument on the fact that, at the time, paragraph (n) of the definition of "gross income" in section 1 of the [Income Tax Act](#) provided that an amount which is recouped is deemed to be income from a South African source.

The taxpayer relied on a later enacted provision, section 9(4)(d) of the Income Tax Act, which expressly provides that amounts resulting from the disposal of an asset which does not fall within the specific South African source provisions of section 9, are from a foreign source. The South African source provisions apply, essentially, to the disposal of assets associated with immovable property or permanent

establishments in South Africa. The aircraft, which triggered the deemed disposal in this matter, did not meet either of these two South African source provisions, as it was clearly not associated with immovable property nor was it part of a South African permanent establishment (as it was used in a business in the United Kingdom). Consequently, if the provisions of section 9(4)(d) are to be applied to the source of the recoupment resulting from the deemed disposal of the foreign aircraft, the source will not be South African.

The taxpayer and SARS applied different approaches to the interpretation of the legislation with SARS following a technical and literal interpretation of the abovementioned provisions, whereas the taxpayer argued that a more unitary approach considering the history and context of the legislation should be followed.

JUDGMENT

The Court, with reference to the Supreme Court judgment in *Natal Joint Municipal Fund v Endumeni Municipality* and the Constitutional Court judgment in *Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs and Tourism*, agreed with the taxpayer and held that a unitary approach should be followed, where the language used in the legislation is the point of departure, however, it must be read in its context, having regard to "*the matter of the statute, its apparent scope and purpose, and within limits, its background*". Moreover, the Court held that the *contra fiscum* rule, which stipulates that should a taxing statutory provision reveal an ambiguity, it should be interpreted in a manner that favours a taxpayer, is accommodated in this unitary approach.

In applying the above principle, the Court held that one must have regard to the legislative history of the provisions in question. **In this regard, the Court took into account the following:**

- The provision on which SARS relied was enacted during the source-based regime as an anti-avoidance provision designed to prevent taxpayers from exporting depreciated assets and then arguing that the proceeds on disposal were from a source outside South Africa, and hence not subject to recoupment tax in South Africa.
- The newer section 9 provision on which the taxpayer relied was enacted during the residence-based tax regime to create a uniform set of source rules to remedy uncertainty and anomalies and eliminate the concept of "deemed source" that existed during the source-based regime.
- Accordingly, the Court held that SARS's argument was based on a literal and isolated interpretation approach, disregarding the context, and that the legislature's intention limits the application of the deemed source rule for recoupments to the "gross income" definition and its scope did not extend to other sections of the Income Tax Act.

In relation to the clear inconsistency between the two provisions, the Court held the following:

- The general rule regarding interpretation in this context is that the Court is to regard an earlier enactment as impliedly repealed by a later one if there is an irreconcilable conflict between the provisions.
- The Income Tax Act expressly states that section 9 applies to all amounts received or accrued, without exception (from tax years ending on or after 1 January 2012), and there was no scope for an argument that it did not regulate the source of some receipts or accruals.
- Accordingly, the section 9 provision relating to source rendered the deeming proviso in the definition of "gross income" obsolete, ineffectual and superfluous.

Finally, regarding the proper interpretation of the Income Tax Act, the Court held that regard should be had to the impact of the two approaches suggested by the litigants, and to ask,

"whether they gave rise to sensible and business-like results, as opposed to insensible or even absurd consequences that could not have been intended".

The Court then went on to discuss five reasons why it would result in un-businesslike consequences to follow SARS's approach where the deeming proviso is elevated above its original purpose (which was a limited anti-avoidance measure under the source basis of taxation). The Court, therefore, agreed with the taxpayer's interpretation as it resulted in the proper symmetry between the foreign income from the deemed disposal of the aircraft and the deduction of foreign assessed losses arising from the same foreign trade. The recoupment was, therefore, correctly regarded as being of a foreign source and the taxpayer was eligible to set off the accumulated foreign assessed trading loss against the recoupment.

COMMENTS

Although the legislature repealed the deeming provision in the definition of "gross income" in 2019, resulting in the subject matter of this dispute no longer being contentious, the value of this judgment is that the Court set out clear guidelines for the proper interpretation of conflicting provisions in tax legislation.

In summary, these guidelines are:

- an interpreter should follow a unitary approach of interpretation (which encapsulates the *contra fiscum* rule of interpretation), where the language used in the legislation remains the point of departure, but the legislation must be read in its specific context;
- when considering the context of legislative provisions, the interpreter should pay attention to the legislative history of the provisions in question;
- where there is an irreconcilable conflict between two provisions, an interpreter should regard an earlier enactment as impliedly repealed by a later one; and
- an interpreter should apply the sensible and business-like test, where the interpreter should have regard to the impact of the interpretative approach followed, by asking, "*whether it gives rise to sensible and business-like results, as opposed to insensible or even absurd consequences that could not have been intended*".



Doelie Lessing

Head of Tax | Head of Private Wealth

[View Profile](#)