COMMISSIONER OF TAXES v BRITISH UNITED SHOE MACHINERY (SA)(PTY) LTD
26 SATC 163

Division:	Federal Supreme Court
Judges:	CLAYDEN CJ, QUÈNET FJ AND FORBES FJ
Date:	16 March, 13 April 1964
Also cited as:	1964 (3) SA 193(FC)

Income tax - Income - Source - Letting of machinery to be used in specified place - Source of rental where such use to be made - Section 8(1), Act 16 of 1954(Fed).

Appeal from a decision in the High Court of Southern Rhodesia.

The respondent company was registered, managed and controlled in the Republic of South Africa, where it had its registered office in Port Elizabeth.

The business of the company was that of a dealer in machinery used in the manufacture of footwear. It either sold or leased that machinery, the rental of leased machinery bringing in 59 percent of its income.

Leases for the machines, after being signed by the prospective lessees, were all completed by the signature of the respondent company at Port Elizabeth. Under the leases the lessee undertook to pay a premium, transport charges from Port Elizabeth to his factory and a monthly rental. The place where

the machinery was to be used was specified in the contract of lease and subletting was prohibited. The lessee further undertook to keep the machines in good running order and to redeliver them at Port Elizabeth on the termination of the lease.

The respondent company had no branch office in Rhodesia and no canvassing for lease business was carried on in that territory.

During the years of assessment under review the respondent company derived income from leases entered into by manufacturers in Southern Rhodesia and was assessed by the Commissioner of Taxes upon such income as having been derived from sources in the Federation.

The company having appealed against such assessments to the High Court of Southern Rhodesia, that Court (Young J.) allowed the appeal, holding that the source of the company's income was not within the Federation as there was no activity of the company in the Federation which brought about the payment of the income inasmuch as all the transactions were controlled in Port Elizabeth.

On appeal by the Commissioner to the Federal Supreme Court:

Held, allowing the appeal with costs and confirming the assessments made by the Commissioner, that when income is derived from the use of movable property in a certain place, the source of that income is to be found where that property is used.

N.R. Pudney, for the appellant.

W.H.G. Newham, for the respondent.

Cur. adv. vult.

Postea (13th April).

CLAYDEN CJ: This appeal relates to the source of income of the respondent. The definition of 'gross income' in the Federal Income Tax Act, 16 of 1954, provides that what is included must be 'from any source within the Federation'. If the income in issue was from such a source it is taxable; if it was not it is not.

The respondent company is registered, managed and controlled in the Republic of South Africa and has its registered office at Port Elizabeth. It carries on business in a large way as a dealer in all sorts of machinery used in the manufacture of footwear; it either sells or leases that machinery. The leasing of machines brings in 59 per cent of the respondent's total income. Most of the machines are leased in South Africa, but there is a growing trade in Southern Rhodesia. In the year ended 31st March, 1961, the income from Southern Rhodesia was over £3,500.

The leases, after being signed by the lessees at any place, are all signed by the respondent, so as to give them force, at Port Elizabeth. The older leases were for ten years, but the more recent ones are for five years with an option for renewal. The lessee undertakes to pay a premium, transport charges to the lessee's factory, and monthly rent. The place where the machinery is to be used is specified in the lease. Sub-letting is prohibited. The lessee is

responsible for repairs and for keeping the machines in good running order, but in practice the

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respondent services the machinery at regular intervals free of charge. On the termination of the lease the lessee is bound to redeliver the machines to Port Elizabeth at his expense.

Though the respondent has sales representatives in Rhodesia there is no canvassing for lease business and there is no branch office in Rhodesia.

For small items of machinery an agreement called a Loan Form, signed only by the lessee wherever he may be, is used. On the facts which are before us income from these agreements can be disregarded.

In respect of the years 1954 to 1961 the respondent was assessed to tax on the income paid by lessees in the Federation. The respondent appealed against these assessments, and his appeal was allowed in the High Court, and the assessments were set aside. The basis of the judgment of Young J. was that the source of the income was not within the Federation as there was no activity of the respondent in the Federation which brought about the payment of the income, for all the transactions were controlled in Port Elizabeth.

In *Liquidator Rhodesia Metals, Ltd.* (*In Liq.*) *v Commissioner of Taxes* [1940] A.C. 774 at 789; 1940 A.D. 4321 at 436; Lord Atkin accepted that 'source means not a legal concept but something which a practical man would regard as a real source of income', and that 'the ascertaining of the actual source is a practical hard matter of fact'.

It was explained by Watermeyer C.J. in *Commissioner for Inland Revenue v Lever Bros.,* 1946 A.D. 4412 at 450, in regard to the meaning of the word 'source' that:

> 'The source of receipts, received as income, is not the quarter whence they come, but the originating cause of their being received as income, and that this originating cause is the work which the taxpayer does to earn them, the *quid pro quo* which he gives in return for which he receives them. The work which he does may be a business which he carries on, or an enterprise which he undertakes, or an activity in which he engages and it may take the form of personal exertion, mental or physical, or it may take the form of employment of capital either by using it to earn income or by letting its use to someone else. Often the work is some combination of these.'

He went on to explain at 451 that 'source' of a particular receipt may be located partly in one country and partly in another.

In a dissenting judgment on the facts Schreiner J.A. at 458 set out the law in somewhat similar terms. He said that with a few exceptions, a taxpayer obtains income from others

> '(a) because he renders them services, or(b) because they have the use of his property, or(c) because he carried on . . . profit-producing activities . . .'

In regard to(b) he said that 'the property itself . . . or its use is treated as the source of the income'. He continued:

> 'Where we are dealing with income which the taxpayer gets because someone is using his property and is prepared to pay him for its use, the taxpayer's activities, whether past or present, are in practice disregarded in describing the source of his income. We say simply . . . that he derives his income from land, shares or

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> loans. If per chance we speak of his deriving his income from rent, dividends or interest we are obviously speaking loosely, for those things are his income itself and not its source. What is important is that no one would ordinarily speak of the taxpayer's deriving his income from the contract by which he leased the land, or bought the shares, or loaned the money.'

These I consider are the principles which have to be applied in this case in order to determine what a practical man would say was the real source of the receipts of the respondent.

Before considering the facts in this case I must refer to certain other decisions. Young J. cited, and distinguished, a passage from *Silke on South African Income Tax*, 3rd ed. p. 103, in which it is said that where the income comes by way of rent of a thing the source is the asset which is used, and the location of the source is where the asset is used. Support for this passage is derived from South African *Income Tax Case No* 170, 5 SATC 164. With respect it does not seem to me that the case supports the passage. A South African company had engaged in drilling contracts in Northern Rhodesia. It had drilling equipment there, and a resident supervisor with power to negotiate drilling contracts. At a later stage the company leased its drilling machines, by contract wholly concluded in Northern Rhodesia. Thereafter it maintained its own store, for spares, and office in Northern Rhodesia. Two reasons were given for the decision that the source of the rents was not in South Africa; one was that the company had employed its capital in Rhodesia; the other was that the contract was made in Rhodesia. It seems clear that the company had engaged in business in Rhodesia, and was using its property there to earn money, and there was little to associate the source with South Africa except an original decision to operate in Rhodesia. I do not think that the case affects the present one, or justifies the wide view of the textbook.

A case on the other side is *James Fenwick & Co., Ltd. v The Federal Commissioner of Taxation*(1921) 29 C.L.R. 164. The taxpayer owned two tugs in Australia which were requisitioned at Sydney during the 1914-1918 war by the Admiralty. Thereafter the tugs were taken out of Australian waters. The taxpayer claimed that the moneys paid for the hire while the vessels were away from Australia was not taxable as it was not from a source within the country.

Knox C.J., giving the judgment of the High Court, said:

> '. . . it was utterly immaterial to the appellant where the tugs were taken, where they were used, or whether they were used at all, or what became of them. The appellant had the same right to compensation whatever was done with the tugs, because, and only because, they had been requisitioned . . . In that state of facts we think that the real practical source of this income was the taking of the tugs in Australia. Consequently the source of the income is in Australia . . .'

The learned Judge in the High Court entered upon the inquiry whether or not the value or wealth which was converted into income was wholly or partially created within the Federation. And in this regard he referred to *Commissioner of Taxation of Western Australia v D. & W*.

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Murray, Ltd. (1929) 42 C.L.R. 332. That was a case to do with the sale of goods and in such a case the place where the enhancement of value takes place, so that an article bought at a price can be sold at a greater price, may be of importance in determining source. For instance, the transporting of goods to a country where they are scarce and realize a high price, or provision for retail sales of goods bought wholesale in large quantities may create value. This could happen too with the lease of movables. If a taxpayer took usable machinery to a place where it was hard to come by and there leased it at a high rent, that would no doubt be a factor of importance in determining source. I do not think that in this case the learned Judge was deciding the case on the question whether or not there had been enhancement; rather I think he was applying another test to reinforce a decision. I would only say that to me it does not seem that the absence of enhancement in value in a case such as this can in any way be conclusive in the determination of a source for this income.

Looked at from a practical point of view it is I consider the machines, and not the capital which was invested in the machines, which, by being let out to use, produce the income. The source of the income is because someone is using the machines, the property of the respondent. With the hire of smaller things for a more limited period, for example motor-cars, it is rather the business of the lessor than the property leased which is the source. Such cases would fall under the example(c) set out by Schreiner J.A. And the location of the source would probably be the location of the profit-producing activities, and the occasional use of property in another country would probably be ignored. This case I think clearly falls under the example(b). The respondent obtains income because persons have the use of his property. And here one has two conflicting guides to the location of that source. If the contract under which use is granted is looked to, the source must be in South Africa. If the place where the income-producing asset does produce the income is looked to, the source must be in Rhodesia. Neither guide is conclusive, as appears from the cases to which I have referred. This case is not like that of the tugs: the lessor of the property was concerned with where his machines were to be used, for he made it a condition of the agreement that they should be used at, and only at, a particular place in Rhodesia.

It is obvious that there cannot be an inexhaustible market in which to lease machinery used in the manufacture of footwear. And if a lessor of such machinery has such quantities of it for hire that he can hire it out not only in his own country but in an adjoining country, it seems to me that it is an inescapable conclusion that he means to make money through the use of that machinery in that other country. If that is so, it does not seem to me to matter that would-be users of the machinery have to go to the lessor to get it, and have to pay to take it to where they want to use it. The lessor is opening up another market for his hiring activities. And when the property produces income in that other

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market the source of that income is I consider where the market is. I consider that it is clear that with property of this nature, and leases of so long duration so that the emphasis is on the property and not on the business of the lessor, the source of income derived from the property is where the property is used.

I consider that the appeal should be allowed with costs in this Court, and that the assessments for the years ending 31st March, 1954 to 1961, inclusive should be confirmed.

Quènet F.J. and Forbes F.J. concurred.

Footnotes

1 11 SATC 244.
2 14 SATC 1.