COMMISSIONER FOR INLAND REVENUE v LEVER BROTHERS & UNILEVER LTD
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Division:	Appellate Divison
Judges:	WATERMEYER CJ, SCHREINER JA AND DAVIS AJA
Date:	30 March 1946
Also cited as:	1946 AD 441

Income Tax - Income - Source within the Union - Interest payable in respect of indebtedness assumed by company resident in the Union - Whether the source of such interest the indebtedness or the business operations of creditor company - Source and the location of source considered - Sections 7 and 81, Act 31 of 1941, as amended by section 10, Act 39 of 1945.

Case stated by the Special Court for hearing Income Tax Appeals, under the provisions of section 81 of the Income Tax Act, No 31 of 1941, as amended by section 10 of Act 39 of 1945.

The respondent company was a holding company carrying on business in England. In 1937 it entered into an agreement with a company in Holland, under which the Dutch company acquired certain assets from the respondent company and became indebted to the respondent company in the sum of £11,000,000, upon which it agreed to pay interest. As security for this indebtedness, the Dutch company lodged with a company in England, as trustee, shares in excess of the amount of the indebtedness, the major part of which were shares in an American company carrying on business in the United States.

In March, 1939, a company was formed in the Union of South Africa, and a series of agreements were entered into between the companies, the result of which was to vest in the South African company all the interests of the Dutch company in the shares held by the trustee company as security for the Dutch company's indebtedness and to place the South African company in the position of the Dutch company as regards its rights and liabilities under the original trust agreements. Under these agreements the place of payment was shifted from Rotterdam to London, and all future payments were required to be made by the South African company by sterling cheque on London.

None of these agreements was made in the Union of South Africa, but they were assented to by the Union Treasury, upon the condition that no payment of capital or interest would be made by the South African company from assets in the Union. The interest due under the agreements for the years 1940, 1941 and 1942 was, in fact, paid out of moneys received by the South African company in the United States, as dividends on the American shares included in the securities held by the trustee company. Upon the interest so paid, the Commissioner for Inland Revenue levied assessments upon the respondent company, as being taxable as income under the Union Income Tax Act, No 31 of 1941. Whereupon the respondent company lodged objection and appeal against the assessments so made, which appeal was allowed by the Special Court for hearing Income Tax Appeals, which ordered the assessments made to be amended accordingly.

Thereafter the Commissioner, being dissatisfied with the determination as being erroneous in law, required the Special Court to state a case, by agreement with the respondent company, for an appeal to the Appellate Division of the Supreme Court.

Held, by a majority (SCHREINER, JA, dissenting), dismissing the appeal, that inasmuch as no business was carried on by the respondent company in South Africa, no contract had been made by them in South Africa, no capital had been adventured by them in South Africa, no services had been rendered by them in South Africa and no obligation resting on either party to the agreements had been performed or was to be performed in South Africa, the source of the interest received by the respondent company under the agreements was not to be located in South Africa.

SCHREINER, JA, in dissenting, held that the interest paid found its source in the indebtedness which had been assumed by the South African company, and that as that company was resident in the Union of South Africa, the source of the income derived by the respondent company was situated in the Union.

WATERMEYER CJ: This is an appeal, on a case stated by the Special Income Tax Court under the provisions of sec 81 of Act 31 of 1941, as amended by sec 10 of Act 39 of 1945.

Lever Brothers and Unilever Ltd. and Associated Enterprises Ltd. are two English companies which were assessed for South African Income Tax for the years 1940 to 1942, in respect of money received by them from a third

company, registered in South Africa under the name of Overseas Holdings (Pty.) Ltd. (I shall refer to the first company as Levers and to the third as Overseas Holdings).

The Special Court held that Levers and Associated Enterprises Ltd. were not liable to pay income tax, because the source of their income was not located within the Union. This Special Case raises the question whether or not that decision was correct.

The facts stated in the Special Case relate only to Levers, as it was agreed between the parties that the position of Associated Enterprises Ltd., which is described as a subsidiary of Levers, was similar to that of Levers and a decision in the one case would settle the dispute arising in the other case. Levers is described in the stated case as a holding company and its issued capital is £60,000,000. At the time of the transactions which gave rise to this case it held shares in various trading companies in England and throughout the Empire.

It did not carry on any business nor did it own any capital within the Union of South Africa, unless a debt owed to it by Overseas Holdings can properly be described as capital which it owns within the Union. Lever Brothers and Unilever N.V. is another holding company registered in Holland. At the time of the transactions to which I shall refer it held shares in another group of associated trading companies which carried on business outside the British Empire. These two holding companies are closely associated; the shareholders differ, but until the war the directors of the two companies were the same and there was in existence an agreement between the companies for the equalisation of the dividends on and capital values of the ordinary shares in the two companies.

In both companies the right to nominate directors was vested in particular shares, and these shares were held or controlled by the English and Dutch companies respectively.

Mavibel (Maatschappy voor Internationale Beleggingen N.V.) was a Dutch company; it is described as a subsidiary of Lever Brothers and Unilever N.V. and its registered office was at Rotterdam. The Whitehall Trust Ltd. (which I shall refer to as the trustee) is an English company, which acts as trustee under certain agreements which will be referred to presently; it holds shares in a South African company (Internationale Maatschappy voor Handel en Nywerheid Beperk) on behalf of Associated Enterprises and on behalf of Levers.

On 31st December, 1937, an agreement was entered into at Rotterdam between Levers, Mavibel and the trustee, which was subsequently amended by a further agreement entered into at Rotterdam on 5th April, 1939. These two agreements will be referred to as the trust agreements. They were somewhat involved but, reading the two together, their effect, so far as it is material for the purposes of this case, is as follows:-

Levers sold and transferred to Mavibel shares to the value of £4,986,483 9s. 4d. in various trading and manufacturing concerns carrying on business in different parts of the world and also ceded to them debts to the value of £6,924,505 17s. 1d. owed to Levers by two Dutch soap-making companies. In consideration of these transfers and cessions Mavibel paid to Levers £892,989 6s. 5d. and became liable to them for a sum of £11,000,000 which Mavibel agreed to pay to Levers on or before 31st December, 1961. Until this amount was paid Mavibel agreed to pay interest on the amount due at the rate of 3 per cent. per annum or at such higher rate as from time to time might be agreed upon between the parties. By a subsequent agreement the rate was increased to 3½ per cent. per annum.

As security for the amount owing Mavibel transferred to or deposited with the trustee shares, which were owned by Mavibel and valued at £2,282,865 11s. 2d. and in addition 340,000 shares in an American company known as Lever Brothers Company of Boston. These latter shares were valued at £9,589,719 14s. 10d. and were owned by a Dutch soap-making company which was known as N.V. Vereenigde Zeepfabrieken and was described in the Special Case as a subsidiary of Mavibel. The trustee undertook to hold all these shares on behalf of Mavibel and of the Dutch company and these companies were entitled to draw the dividends on the shares. The trustee could not transfer or deal with the shares without the consent of Levers unless the principal debt had been fully paid. The agreements also contained certain provisions which gave Levers effective control over the shares in the event of the occurrence in the future of certain possibilities.

In particular it was provided that if Mavibel failed to perform any of the obligations imposed upon it by the agreements then the trustee was to hold the shares on behalf of Levers, the debt would be cancelled and any difference between the amount of the debt and the value of the shares would be adjusted by a money payment. This provision as well as those which are referred to below were agreed to by the Dutch company which owned the shares in the American company. Another notable provision was as follows:-

"In the event of any war rebellion civil commotion or political or constitutional disturbance or change affecting England the Netherlands or any country in which any of the Companies or Corporate Bodies whose capitals comprise any of the Shares are

domiciled or any law being passed or any act being done as a result of which the property in the Shares or any benefits directly or indirectly receivable therefrom would but for the provisions of this Clause pass to any Government or to any third party or the rights of Levers or Mavibel under this Trust Instrument or the beneficial

interest of Mavibel in the Sold Shares or the beneficial ownership of the Pledged Shares in the opinion of Levers and Mavibel or failing their agreeing in the opinion of the Trustee (whose decision in this respect shall be final and conclusive) being for any reason in jeopardy or likely to be jeopardised (all or any of which events are hereinafter referred to as 'the emergency') then and in any such case (but only if Levers shall so direct) the Shares or such of them as Levers shall direct shall be held by the Trustee in trust for Levers and the portion of the amount owing on the security of this Trust Instrument represented by the then value of the said Shares (such value to be ascertained in accordance with the provisions set out in the Second Schedule hereto) shall be cancelled.

PROVIDED ALWAYS that:-

(1) In the event of the value of the Shares so to be held in trust for Levers being in excess of the amount then owing on the security of this Trust Instrument then any such excess shall be a debt due by Levers to Mavibel and shall be paid to Mavibel or the Trustee for Mavibel's account but the existence of any such debt shall not affect Levers' title to the Shares. The amount so paid or payable plus the amount of the loan so cancelled is hereinafter referred to as 'the purchase price.' Any payments due to be made by Levers under this sub-clause shall carry interest at the rate of 4 per cent. per annum."

Another provision dealt with depreciation in the value of the shares held by the trustee. If that event occurred then Levers could direct the trustee to call upon Mavibel to reduce its indebtedness or furnish additional security and if it failed to do so then the shares were to be held by the trustee in trust for Levers. Another provision dealt with equalisation of profits between Levers and Lever Brothers and Unilever N.V. It was as follows:-

"If at any time when the Shares or any of them are held in Trust for Levers under the provisions of this clause the current profits of Lever Brothers & Unilever N.V. (hereinafter called 'the Dutch Company') as defined in Clause 1 of the Agreement for

Distribution of Profits and Assets made between the Dutch Company and Levers on the 31st day of December 1936 shall be insufficient to provide in full the dividends (and arrears if any) on the Preference Shares of the Dutch Company in respect of any financial period or if there be no current profits of the Dutch Company Levers shall to the extent of all profits available for distribution by way of dividend for the financial period in respect of the Shares or any of them as aforesaid less an amount equal to interest at the rate ruling or at the last rate ruling hereunder calculated on the purchase price be under obligation to make good any losses incurred by the Dutch Company during the same financial period and to make up the current profits of the Dutch Company to the amount of the dividends (and arrears if any) on its Preference Shares. Any contributions so falling to be made by Levers shall be paid by Levers to Mavibel for the account of the Dutch Company. Conversely if in any financial period by reason of the said profits being less than the amount of the said interest the current profits of Levers should be insufficient to provide in full the dividends (and arrears if any) on its Preference Shares in respect of the same financial period or there should be no current profits of Levers then Mavibel shall to the extent of the amount by which the said interest would have exceeded the said profits be under obligation to make good any losses incurred by Levers during that period and to make up the current profits of Levers to the amount of the dividends (and arrears if any) on the Preference Shares of Levers."

On 15th March, 1939, on the instructions of Levers, Overseas Holdings was incorporated in the Union of South Africa. Its capital was £10,000 in shares of £1 each. On the same day another Company, Internationale Maatscappy voor Handel en Nywerheid Beperk, was also incorporated in the Union with a share capital of £10,000 divided into 900 shares of £10 each and 100 special ordinary shares of £10 each; 999 of the shares in the first Company were held by the second Company; the special ordinary shares in the second Company, which conferred on the holders the exclusive right to nominate the directors, were held by Associated Enterprises Ltd. and the remaining 900 shares were held by Lever Brothers and Unilever N.V.

Thereafter a number of agreements were made between interested parties, the effect of which was that Overseas Holdings bought from Mavibel and the Dutch Company their entire interest in the

shares held as security by the Whitehall Trust, and subject to certain modifications stepped into the shoes of Mavibel so far as the rights and liabilities under the trust agreements of 31st December, 1937, and 5th April, 1939, were concerned.

One important modification related to the place of payment. Under the original trust agreements payments to be made by Mavibel had to be made at their registered office in Rotterdam whereas under the agreement made in March, 1940, future payments to be made by Overseas Holdings were to be made at Levers' registered office in England by sterling cheque on London.

The purpose of all these manoeuvres is not quite clear. Probably the substitution of Overseas Holdings for Mavibel was effected in order to avert certain consequences which were foreseen if Holland were occupied by the enemy, but the reason for the initial creation of Mavibel is a matter of conjecture.

None of the agreements, whereby Overseas Holdings bought the interests of Mavibel and of the Dutch Company, and became substituted in the place of Mavibel under the trust agreements, were entered into within the Union of South Africa. They were however assented to by the Union Treasury, under certain Emergency Finance Regulations, upon the condition that no payment of capital or interest would be made by Overseas Holdings from assets in the

Union.

The interest due to Levers during the income tax years ending on 30th June in each of the years 1940, 1941 and 1942, amounting in all to £820,000, was, in fact, paid out of the monies received by Overseas Holdings in the United States, as dividends on the American shares held by them.

The Commissioner for Inland Revenue claimed that the interest thus paid by Overseas Holdings to Levers was taxable as income under the Union Income Tax Act (31 of 1941), and assessed Income Tax on it accordingly.

The Special Court rejected his claim and the question before us on appeal is whether that interest was taxable under the South African Income Tax Act.

According to the definition contained in sec 7 of Act 31 of 1941 "gross income" means the total amount which has been received by or which has accrued to a taxpayer from a source which is within the Union or which is deemed to be within the Union other than receipts and accruals of a capital nature. The

Commissioner claims that this interest was not a receipt of a capital nature and was received from a source which was within the Union, because it was interest on a loan of money made to a company incorporated in South Africa. His contention in support of that claim is as follows: the "source" of interest paid on a loan of money is the principal debt; the debt is regarded in law as located where the debtor resides; in this case the debtor was a South African Company, therefore the debt was located in South Africa, therefore the interest was received from a source in South Africa.

Prima facie, this contention appears to be somewhat artificial, because of the figurative character of the language in which it is couched.

A debt is a legal obligation, something having no corporeal existence; consequently it can have no real and actual situation in the material world. Metaphorically, however, by legal fiction it may have a situation in a place, determined by accepted legal rules. Furthermore the word "source," when used as it is in this Act in order to symbolise the origin of "gross income" received by a taxpayer, is also a metaphorical expression and the sense in which it is used in the Act must be determined.

When the question has to be decided whether or not money received by a taxpayer is "gross income" within the meaning of the definition referred to above, two problems arise which have not always been differentiated from one another in decided cases. The first problem is to determine what is the source from which it has been received and when that has been determined the second problem is to locate it in order to decide whether it is or is not within the Union.

The word "source" has several possible meanings. In this section it is used figuratively, and when so used in relation to the receipt of money one possible meaning is the originating cause of the receipt of the money, another possible meaning is the quarter from which it is received. A series of decisions of this Court and of the Judicial Committee of the Privy Council upon our Income Tax Acts and upon similar Acts elsewhere have dealt with the meaning of the word "source" and the inference, which, I think, should be drawn from those decisions is 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. It is sometimes said colloquially, and it was argued in this case that when money is lent at interest the source of the interest is the debt resulting from the loan of the money. But that is a misconception which arises, I think, from giving a figurative meaning to the word "source" or to the word "debt". To illustrate my meaning let us compare a loan at interest with a letting of property. Clearly the legal aspect of the two contracts correspond very closely. In each the use of property is given by one party to the other in return for periodical money payments. There is, of course, one cardinal difference, one is a lease and the other is a *mutuum*. In a letting and hiring of property the ownership of the property never passes and it has to be restored to the owner at the end of the lease; in a loan of money on the other hand the same money need not be returned. Although the same money need not be returned, the same amount, as a rule, must be repaid. This difference does not affect the analogy which I am drawing. Each contract imposes a debt or obligation, in the one case on the borrower, in the other case on the lessor, to return something (money or property) to the lender or lessor at the end of the agreed period. Now the "debt", which it is argued is the source of the interest on a loan, is this legal obligation resting on the borrower to repay the loan at the end of the agreed period. If the argument that the debt is the source of the interest which is received as income were sound it would follow by parity of reasoning that the obligation on a lessee to redeliver the leased premises would be the source of rent received by a lessor as income. Such a conclusion has only to be stated to refute itself and its statement shews to what surprising results the use of figurative language in a legal problem may lead.

In the case of a loan of money the lender gives the money to the borrower, who in return incurs an obligation to repay the same amount of money at some future time and if the loan is one which bears interest, he also incurs an obligation to pay that interest. Though I use the words "gives the money" this must not be

taken literally as the usual way of making a loan. As a rule the lender either gives credit to the borrower or transfers to him certain rights of obtaining credit which had previously belonged to the lender, and this supply of credit is the service which the lender performs for the borrower, in return for which the borrower pays him interest. Consequently this provision of credit is the originating cause or source of the interest received by the lender. Although, colloquially, one speaks of a debt carrying interest, or interest on a debt, as though interest were a sort of growth sprouting from the debt, the language used means no more than that the borrower pays interest, if that is the agreement between borrower and lender, as consideration for the benefits allowed to him by the lender.

Turning now to the problem of locating a source of income, it is obvious that a taxpayer's activities, which are the originating cause of a particular receipt, need not all occur in the same place and may even occur in different countries, and consequently, after the activities which are the source of the particular "gross income" have been identified the problem of locating them may present considerable difficulties, and it may be necessary to come to the conclusion that the "source" of a particular receipt is located partly in one country and partly in another. See remarks of Lord ATKINS in *Rhodesia Metals, Ltd. (in Liquidation) v Commissioner of Taxes* (1940, A.D. 432, at p. 436).1 Such a state of affairs may lead to the conclusion that the whole of a receipt, or part of it, or none of it is taxable as income from a source within the Union, according to the particular circumstances of the case, but I am not aware of any decision which has laid down clearly what would be the governing consideration in such a case.

These principles can, I think, properly be extracted from the case to which I shall now refer.

In the case of *Commissioner of Taxes v Kirk* (1900 A.C. 588) the Privy Council had to deal with the income of a mining and smelting company incorporated and having its head office in Victoria which carried on mining and smelting in New South Wales and which sold its products in Melbourne(Victoria) and in London.

The question for decision was whether the company had any income taxable in New South Wales, as income arising or accruing from trade carried on in New South Wales, or as income arising

or accruing from any other source whatsoever in New South Wales. The Privy Council held that the smelting process carried on in New South Wales was certainly included within the words "any other source whatsoever" and consequently that the company had some income derived from this "source" which was taxable in New South Wales. How the amount of that income was ultimately determined does not appear.

The question of where certain business operations, producing income, were located was also considered by the Privy Council in the cases of *Grainger v Gough* (1896, A.C. 325), *Commissioner of Taxes for New Zealand v Eastern Extension Australasia and China Telegraph Co. Ltd.* (1906, A.C. 526) *and Lovell & Christmas Ltd. v Commissioner of Taxes* (1907, A.C. 46) and in the last case Sir ARTHUR WILSON in giving his judgement said: "The trade or business in question ... ordinarily consists in making certain classes of contracts and in carrying those contracts into operation with a view to profit; and the rule seems to be that where such contracts, forming, as they do, the essence of the business or trade, are habitually made there a trade or business is carried on within the meaning of the Income Tax Acts"

In the case of *Commissioner of Taxes v Dunn & Co., Ltd.* (1918, A.D. 607) INNES, C.J., at page 615, said: "In order to ascertain where the capital was employed to earn the profits sought to be taxed, we must have regard to the source from which they are derived. And that source, in the present case, was the company's English business. It employed its own capital in carrying on its own business in England, and by so doing it earned the interest which it is now desired to assess. It was not contended by the *Attorney-General* that the mere fact that the debtor was in South Africa affected the matter; and he was right in refraining from so contending." In the case of *Overseas Trust Co. Ltd. v Commissioner for Inland Revenue* (1925, A.D. 444).2 INNES, C.J., after deciding that the amount in question in that case was "gross income" remarked at page 543: "It remains to localise the source of this income. This is an enquiry in some cases of considerable difficulty. This Court, in *Commissioner of Taxes v Dunn & Co.* (1918, A.D. p. 607) looked to the place where the capital was employed to earn the income in determining the source of that income. And that seems to have been the general rule of the Australian

Courts in construing an Act very similar on this point to our own. (See Rydge *Commonwealth Income Tax Acts*, p. 43). Menzies Murray *Income Tax Act Annotated*, p. 35, remarks that 'the source of any income may be said generally to be the location of the business, capital, or service which produces the income. If this income-producer is located in the Union, then the particular income has been earned from a source within the Union.' That fairly expresses the result of the decisions, bearing in mind however that 'source' denotes origin, not location, and that capital which produces profit is located where it is employed."

The statement by *Menzies Murray* which is quoted above by INNES, C.J. would have been more accurate if the words "the location of" had been omitted. It then bears a striking similarity to the statement in Rydge *Income Tax* page 43, referred to above, which is as follows:

> "The source of income may be said to be the business capital or service which is responsible for the earning of the income. If the capital or services be located in Australia then the particular income has been earned within the

Commonwealth." The statement in the judgment of INNES, C.J. that the word "source" denotes "origin" and not "location" should be noticed. It means that the word "source" in the Act does not denote the quarter from which the money is received but the originating cause of the receipt (i.e., the particular activity of the taxpayer which earns money). In a later passage in his judgment when dealing with the contention that the source of profits, derived by the taxpayer (a South African Company) from the purchase of certain shares in a company in liquidation in South-West Africa and the subsequent sale of such shares at a profit through brokers in Germany was located in Germany he said: "Now these isolated transactions were controlled throughout from the Cape Town office. There was no proof that the Overseas Trust carried on business in Germany or employed any of its capital there. The brokers were merely its agents executing its instructions and the profit was earned by the capital paid for the shares. That capital was employed in the Union; so the second question was rightly answered in favour of the Commissioner."

In *Millin v Commissioner for Inland Revenue* (1928, A.D. 207),3 this Court held that the "source" of royalties received by a South

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African novelist from her publishers in England was the employment of her faculties within the Union in writing the novels and in making contracts for publication with her publishers. The question whether or not the source was partly located in South Africa and partly in England was discussed, particularly with reference to the decision in *Kirk's* case (*ubi sup.*) and to certain subsequent Australian decisions, but it was decided against the taxpayer.

In the case of *Rhodesia Metals Ltd. v Commissioner of Taxes* (1938, A.D. 282),4 this Court followed the decision in the *Overseas Trust* case. That decision was upheld by the Judicial Committee of the Privy Council (1940, A.D. 432).5 Lord ATKIN in his judgment mentioned the cases of *Dunn* and the *Overseas Trust* and said that their Lordships had no criticism to make of those decisions. He pointed out, however, that income could be derived from more than one source even if that source was business. He declined to formulate a definition which would furnish a universal test for determining when an amount "is received from a source within the territory" (probably an impossible task) but he doubted whether the determination of the place where the capital was productively employed helped "to define the situation", probably because it might be productively employed in more than one place. He referred with approval to the following extracts from the dissenting judgment of DE VILLIERS, J.A. in the *Rhodesia Metals* case in this Court. "Source means not a legal concept but something which the practical man would regard as a real source of income. The ascertaining of the actual source is a practical hard matter of fact." This is a quotation taken from a judgment of ISAACS, J., in an Australian case, *Nathan v F.C. of Taxes* (25, C.L.R. 183), in which the Court decided that the source of dividends received by a shareholder in a company was the business carried on by the company which earned the money out of which dividends were paid. I have not seen a copy of the judgment in that case but the Court seems to have brushed aside the legal idea of a company being a separate *persona* distinct from its shareholders and to have dealt with the shareholder as if he were a partner in the activities of the company, thus deriving his income from the same source as that from which the company derived its income. Certain remarks of INNES, C.J., in the *Overseas Trust* case at the top of page 454 seem to agree with that view.

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I turn now to the facts of the present case. Overseas Holdings by means of certain contracts made in London and Holland acquired the ownership of all the shares held in trust by the trustee and assumed obligations towards Levers and the Trustee, which theretofore had rested upon Mavibel. The contracts were agreements which dealt entirely with incorporeal rights, the shares were in companies none of which carried on any business in South Africa. The activities of Levers which resulted in an obligation binding Overseas Holdings to pay interest upon £11,000,000 to Levers were confined to making or consenting to and carrying out the contracts by virtue of which Overseas Holdings acquired the ownership of shares pledged to Levers in certain non-South African companies, and by virtue of which the obligation to pay interest arose. In short, Levers, before the contract with Mavibel was made, were the owners of property represented by shares in companies and debts owed to them. None of this property was situated in South Africa. They sold this property in London to Mavibel under conditions whereby Mavibel did not pay the purchase price immediately but paid interest on the purchase price until it was finally paid and whereby the shares were to remain in London pledged as security for the fulfilment of the obligations due by Mavibel under the contract. This sale took place in England and not in South Africa and Levers performed their obligations under the contract in England. Subsequently, Overseas Holdings stepped into Mavibel's shoes and Levers performed its obligations under the contracts which included the provisions of credit in England and by these services earned the income now sought to be taxed.

No business was carried on by Levers in South Africa, no contract was made by them in South Africa, no capital was adventured by them in South Africa, no services were rendered by them in South Africa and no obligation resting on either party was performed or was to be performed in South Africa. In fact, there were no activities of any sort by Levers in South Africa except possibly those connected with the flotation of Overseas Holdings in South Africa. Consequently, according to the meaning which, in my opinion, has been given to the word "source" by the decisions of the Privy Council and of this Court, the source of the income which the Commissioner wishes to tax was not located in South Africa. As I have pointed

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out above, to call the debt of £11,000,000 the source of the income is to make use of metaphor. The same may possibly be said of calling the taxpayer's activities the source; but there is a vital distinction which makes the word "source" more appropriate as a metaphorical expression to denote the taxpayer's activities than to denote the debt resulting from them. This distinction lies in the fact that the mere existence of the debt did not entitle the taxpayer to receive money from Overseas Holdings; it was the agreement between the parties that interest should be paid, and the performance by Levers of their obligations under it, which created the right of Levers to receive the money and the corresponding obligation of Overseas Holdings to pay it. So it could more properly be said that it was the making and carrying out of the agreement relating to the £11,000,000 by the taxpayer, which earned the income for him, rather than the existence of the debt resulting from that agreement.

I think I should add that even if the debt could properly be regarded as the source of the money paid by Overseas Holdings to Levers, it is not clear to me, in this particular case, that the debt must necessarily in law be regarded as located in South Africa. It may be that, by a legal fiction, a debt is regarded, in law, as located where a debtor resides; but generally speaking, that fiction is based upon the principle that the debt can be enforced where the debtor resides. I do not wish to enter upon a discussion of a somewhat involved subject, (See the 2nd Edition with appendices of Guthrie's translation of *Savigny's Private International Law*), but a reference to Dicey's *Conflict of Laws* (5th ed. Note 29) is appropriate. He says at page 992: "The effort to find a local situation (of a *chose in action*) is sometimes not altogether easy, but it is submitted that the true principle is that adopted above and approved by POLLOCK, M.R., in *New York Life Assurance Co. v Public Trustee* (1924, 2 Ch. 101), namely, that 'debts or *choses in action*' are generally to be looked upon as situate in the country where they are properly recoverable or can be enforced."

If this be correct, then the debt upon which interest was payable if it was located in South Africa, was also located in London because it was secured by a pledge in London and by the terms of the contract between Levers and Overseas Holdings it was recoverable in London.

Again, if Lord ATKIN'S suggestion be followed and the question

be asked what would the practical man regard as the real source of the income, though I have some difficulty in differentiating the reasoning of the practical man from that of the theoretical lawyer for this purpose, I think the answer would probably be that the source of Levers' income was the operations of the American Companies which produced the money out of which the interest was paid. I cannot think that the practical man could ever come to the conclusion that the money came from a source in South Africa.

For these reasons I come to the conclusion that the Special Court was right. The appeal against their decision will be dismissed with costs.

SCHREINER, J.A.: No question arises in this case as to the validity of taxation measures which have some degree of extraterritorial operation; we are concerned solely with the application of a statute, properly construed, to facts, properly analysed and assessed.

The Union Income Tax Act does not contain any definition of the word "source" as used in the definition of "gross income", nor does the section which, in each of the successive Acts, has provided that in certain circumstances income shall be deemed to be derived from a source within the Union, throw light on the general nature of a source of income for the purposes of the Acts. Our own decisions, however, and those of the Judicial Committee and of the Australian Courts on the generally similar statutes of Australasia and New Zealand have during the present century considerably clarified the conception of "source" for income tax purposes.

Generally it may be said that a source of income is either(a) some personal activity of the tax-payer, or(b) some property over which he has rights, or(c) a combination of both. With a few possible exceptions (one thinks of the coiner and the bank-note forger, who may be said, literally, to make their money, and the primary producer in so far as he produces for his own consumption what is treated as income) the taxpayer obtains his income from other persons(a) because he renders them services, or(b) because they have the use of his property, or(c) because he carries on in the world of commerce and industry profit-producing activities involving in various combinations the transfer of the ownership in property or the grant of its use or the rendering of services.

Even in the case of(b), income derived from the taxpayer's property, it is no doubt possible to describe the source of the income as the activity of the taxpayer in entering into the contract under which the other party agreed to pay the rent, interest, royalty or other recompense for the use of the property. Or it might be said that the source is the owner's continued non-interference with the use by the other party of his property. But neither of these ways of putting the matter would accord with ordinary linguistic usage. In common parlance, by which it is a sound rule to judge definitions, the property itself, or, which for present purposes amounts to the same thing, its use, is treated as the source of the income.

Recognition of the distinction between income derived from the taxpayer's property and income derived on the one hand from services rendered by him and on the other from some profit-making activity is in my view crucial to the decision of this case. I do not agree that we are compelled by authority to find some activity of the taxpayer as in all cases the source of his income. That view is, in my opinion, largely due to the influence of decisions on cases falling under(c), above, the "business" cases, which are not applicable to the type of case with which we are now

concerned.

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 and, as I see it, without the use of metaphor (if indeed that be a criticism of actual usage) that he derives his income from land, shares, or loans. If perchance we speak of his deriving his income from rent, dividends, or interest, we are obviously speaking loosely, for these things are his income itself and not its source. What is important is that no one would ordinarily speak of the taxpayer deriving his income from the contract by which he leased the land or bought the shares or loaned the money. In the case of shares it is possible that the shareholder might under some income tax statutes be looked upon as a partner in the company's business, but no one would speak of the purchase of his shares as the source of his income any more than one would speak of the partnership agreement as the source of the income of a partner. Since in ordinary speech we ignore the taxpayer's activities in describing the source of these kinds of income, there is, in my view, no good reason for treating such activities as the source of such income in contemplation of law.

The class of case coming under(c), in which goods are manufactured or bought and thereafter sold, the taxpayer, deriving a profit in the process, is, of course, extremely common. It normally involves the making of numerous contracts over a period and the taxpayer who gains his income in this way is generally said to carry on a business. The frequency of this type of income production, coupled perhaps with the long established use of the word "business" in the British Statutes, has led to the extension of the notion of a "business" over a large part of the income tax field. The tendency has been to seek the taxpayer's "business" and to treat it as the source of any income obtained by him in connection therewith; and this tendency is to be found even in cases dealing with statutory provisions which, like our own, do not make the profits of a business, as such, a basis of taxation. Care must be taken lest its use in connection with our Act obscure the latter's true foundations. In particular, if income is really derived from the use by another of the taxpayer's property, clarity will generally be better preserved if the concept of "the business of a property owner" is avoided. The income will, no doubt generally, if not invariably, be provided in terms of some contract, but the contract must not be treated as the source of the income by reason merely of the fact that it was a business transaction and was entered into in furtherance of the taxpayer's business.

According to the stated case Levers is a "holding" company, but the description is not explained or elaborated. Presumably such a company does not itself engage in activities such as manufacturing or buying and selling goods; it apparently holds shares and debentures in other companies. But whether it not only holds such securities for the purpose of earning dividends and interest therefrom or whether as many finance companies do, it also buys and sells them from time to time in order to make a profit, does not appear from the stated case. In my view of the issues, however, the question is not of importance. If a finance company, operating in Britain, in the course of its business buys and sells shares in South African companies and also receives dividends from the shares which it is holding, it is, I think, clear that, but for the protection of the exempting sections(10) (1) (k) and 30(1), of Act 31 of 1941, such dividends would be taxable in South Africa as coming from a source within the Union. In the course of carrying on one's business in one country one may derive income from a source in

another country. The decision in *Dunn's* case (1918, A.D. 607), is not inconsistent with this statement. The crux of that decision is to be found in the statements in the judgment of INNES, C.J., at p. 614, that the company in using capital to purchase, invoice and ship the goods "was employing it in its own business, not lending it to the South African firms", and, at p. 615, "Here the relationship of lender and borrower never came into existence".

The interest was treated as simply a part of the charges which the company was entitled to make for carrying out in England its work as agent of the South African buyers. It was not the return on an investment but a by-product of the English agency business.

Interest on a loan investment stands on an entirely different footing. Where the contract of loan was made and where the interest is payable seem to me to be no more relevant in such a case than the corresponding questions in regard to hire of the fixed property. Where a debt arises in the course of trading between two parties, the creditor ordinarily wants payment as soon as possible; if interest is payable it is intended to compensate him for the delay in making payment. But in the case of an investment by way of loan, the creditor is leasing his money to make an income from it; he is, generally speaking, not anxious to have it back so long as his debtor is sound and his security ample. His object, in the first instance, in lending the money was to get what annual payments the borrower was prepared to pay for its use. Essentially, therefore, the interest is the fruit of the money and comes from where the money is, irrespective of where the contract was made or the interest is payable.

In the present case, of course, no money was handed by Levers to Overseas Holdings but the result, in my opinion, is the same. What had happened is that Levers had changed the nature of certain of its investments by disposing of a number of shares and "capital loans" to Mavibel for £11,892,989 6s. 5d., of which only £892,989 6s. 5d. was paid to Levers, the balance remaining on loan for a period of 24 years certain (subject to there being no default) and for an indefinite period thereafter so long as Mavibel did not wish to repay the capital and carried out the terms of the agreement. This was not a case of some relatively small portion of the purchase price remaining unpaid, to be paid at an early convenient date.

It was the conversion of certain investments belonging to Levers

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into a loan investment with Mavibel as the debtor. The elaborate provisions to secure the indebtedness do not alter the essential nature of the transaction. When war had broken out and the threat to Holland was closer, Levers, possibly in accordance with plans made in 1937 when the first agreement was made, arranged for the transfer, should the threat materialise, of its investment to South Africa. In anticipation, it seems, of this possibility, Overseas Holdings(Proprietary) Limited had been registered in South Africa in March, 1939. Not only was it a South African company by reason of its incorporation here but the majority of its five directors resided in Durban where its head office was and where its meetings were held. The residence of the company was undoubtedly in South Africa. When the invasion of Holland took place the previous arrangements found their justification and Overseas Holdings accepted the option granted to it by Mavibel; it took over all the securities purchased by Mavibel from Levers and at the same time, with the consent of the creditor, Levers, became the debtor under the loan. It seems to me that the position was then for present purposes not materially different from what it would have been if the original transaction in 1937 had been entered into between Levers and Overseas Holdings (had it then existed). Where the various transactions were entered into seems to me to be irrelevant to the present enquiry; there is nothing before us to indicate why the trust agreement was made in Holland or why it was specially provided that the document should not be brought into Great Britain. For reasons, presumably, of safety, Levers wished to have as its debtor some person resident in South Africa, and the facilities existing under the company law enabled this to be done without loss of control. Levers did not send a draft for £11,000,000 to Overseas Holdings but the transactions entered into undoubtedly placed the latter in the position of a borrower of that amount from the former. Levers had its investment in the shape of an interest bearing loan to a resident in South Africa. In my view the source of Levers' income, so far as it consisted of the interest, was the debt i.e. the *aes alienum* or money of Levers in the possession of Overseas Holdings. If money had been sent to South Africa the presence of the debt in the Union would perhaps have seemed more obvious but the position is, I think, equally clear without that feature. No doubt the location of an incorporeal in space by a rule of law carries a flavour of artificiality but even the

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practical business man of the cases would realise, when the matter was explained to him, that for certain purposes it is unavoidable. I respectfully agree with what was said by Lord BUCKMASTER in *English, Scottish and Australian Bank Ltd. v Commissioner for Inland Revenue*, (1932, A.C. 238 at p. 246), that, apart from any special rule relating to specialty debts, once it is assumed that a debt must have a local situation, it can only be where the debtor or where the creditor resides. The unanimous decision of the House of Lords in that case was that a debt exists where the debtor resides, and where the residence is outside the United Kingdom the debt is "property locally situate out of the United Kingdom", within the meaning of an exception in the Stamp Duty Act, 1891. It is of interest to note that the decision was based on the established rule in probate and estate duty matters, it being regarded as natural to suppose that the Legislature in passing the Stamp Act assumed that the same rule would be applied in fixing the local situation of *choses in action* for the purposes of the Act. If one treats the locality of a debt as depending on the place where it is recoverable the general rule which is not peculiar to any particular system of law is that *actio sequitur forum rei* and Levers could undoubtedly sue Overseas Holdings in South Africa to recover the capital and interest.

The fact that in addition to this right, based on the general rule, Levers were under the trust agreement given the right to realise the securities lodged in London does not, in my view, lead to a modification of the conclusion to be drawn from the existence of the general rule. If one assumes, as I suppose one should assume, that, in taxing income from sources within the Union, Parliament took into account interest payable on a debt, it is natural to suppose that it envisaged, as the source, the place from which interest would ordinarily come and not the place to which it would go. It would be anomalous to treat as a source of income the residence of the creditor or taxpayer, as such. The residence of the debtor appears to me to be the natural situation of the debt, that is, in the case of a loan investment, of the source of the interest on the debt.

In the present case the actual money with which Overseas Holdings paid the interest that it owed to Levers came almost entirely from America, a small portion coming from London. In arriving at its decision, the Special Court appears to have treated this fact as decisive, but this contention, which was barely referred to in the

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argument before this Court, is in my opinion untenable. Where the debtor obtains the means to pay the interest on his debt and what arrangements he makes for the transfer of the funds to the creditor seems to me to have no bearing on the question in issue. Under certain Emergency Regulations the South African Treasury, before it would approve of the transaction whereby Overseas Holdings became the debtor of Levers, required an undertaking that payments of capital and interest would not be made from funds in the Union. It might seem to the practical business man somewhat surprising that another State department should nevertheless claim that interest, which was not allowed to leave South Africa, should be taxed as having originated here. But the explanation, of course, is that the source of the income is not the place from which the actual money comes.

I have referred to the practical business man whose hypothetical views on these matters are said to be entitled to great weight. And it is suggested that the view that interest on a loan debt has its source in the place where the debt is situated is artificial and based on legal fiction. No doubt excessive subtlety is particularly to be avoided in

the solution of those income tax problems that are closely related to the conduct of affairs in trade and industry. But I am disposed to think that a practical business man would be surprised if he were informed that the source of interest on a long term loan was the contract, made possibly decades ago, and not the loan debt itself. And if he were told that the Statute made it necessary to fix the local situation of the interest bearing debt, it is not unlikely that, while expressing a tentative layman's view in favour of placing it at the residence of the debtor, he would indicate that the obvious thing to do would be to ask a lawyer. But, after all, we are concerned in this case not with ordinary everyday business transactions but with a series of complicated legal documents of an unusual character, designed to create and transfer legal rights in the light of international developments and not, it may be supposed, without some regard to the revenue laws of the countries concerned. What factors induced Levers to select the soil of South Africa as the most favourable one into which to transplant the fruitful tree whose existence in Holland was threatened we do not know, but the precise effect of the operation does not appear to me to be a matter on which the opinion of the ordinary practical business man would provide much assistance.

In conclusion, it should be pointed out that in the case of *Overseas Trust Corporation v Commissioner for Inland Revenue* (1926, A.D. 44), the income of the company was not derived by way of dividends, interest of the like from property situated outside the Union. The income took the form of profits flowing from the acquisition and transfer of property, the relative contracts being entered into within the Union. It flowed from the carrying on of the company's business, not from the ownership of property. It was thus immaterial where the property, the subject of the transactions, was situated. The *Rhodesia Metals'* case (1938, A.D. 282: 1940, A.D. 432), was also concerned with profits on the sale of the company's assets, and has no direct bearing on a case like the present one.

The income in question in this case, was, in my view, derived from property owned by Levers in the Union, namely, the debt owed by Overseas Holdings. I would accordingly allow the appeal.

DAVIS, A.J.A.: I agree that the appeal should be dismissed. Adopting, as I think I am bound to adopt, the test approved by the Privy Council in the *Rhodesia Metals'* case (1940, A.D. 432), I have little doubt that the practical man would say that the source of Levers' income was the provision by it of assets in America and the giving of credit in England. He might have difficulty in deciding whether the source was located in England, where, *inter alia*, the contracts were made, where the trustee was situated, where the credit was given and where all payments had to be made; or whether it was in America where the assets were situated, and where those assets earned the money out of which the interest was paid. But the one place he could not choose would be South Africa. I cannot conceive of the practical man saying that, though the Treasury had only agreed to the transaction going through at all on the express condition that not one penny piece of capital or interest should be paid from any funds in South Africa, and though that condition had been fully carried out and not one penny piece had come from South Africa, yet the Treasury was right in now claiming that the whole of the interest had come from a source in South Africa, although the Treasury and the practical man both knew that as "a practical hard matter of fact" none of it had done so, and that indeed, the debtor possessed no assets in South Africa from which it possibly could have come. For the person

whom Lord ATKIN had in mind was the practical man and not the legal theorist who, by resolutely shutting his eyes to all the facts, could prove that black was white.

Appeal accordingly dismissed.

Footnotes

1 11 SATC 244 at p. 249.
2 2 SATC 71.
3 3 SATC 170.
4 9 SATC 363.
5 11 SATC 244.