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COMMISSIONER FOR INLAND REVENUE v BLACK
21 SATC 226

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Division:	Appellate
Judges:	SCHREINER ACJ, STEYN JA, REYNOLDS JA, MALAN JA AND PRICE AJA
Date:	4 and 13 June 1957
Also cited as:	1957 (3) SA 536(A)

Income tax - Income - Source - Stockbroker carrying on business in the Union - Share transactions on London market carried out through London firm of stockbrokers - Shares purchased, paid for, held, sold and delivered by firm in London, where proceeds received - Stockbroker also dealing in shares on local market - Whether profit from deals on London market income derived from source within the Union - Section 7, Act 31 of 1941, as amended.

Appeal upon a stated case from a decision of the Special Court for hearing Income Tax Appeals, in terms of section 81(1)(b) of the Income Tax Act, No 31 of 1941, as amended.

Respondent resided in Johannesburg and carried on business there as a stockbroker in partnership with others. Respondent's firm carried on arbitrage business on joint account with a firm of London brokers, but otherwise did not job in shares on its own account. Respondent himself carried on a private business, separate from the firm's business, of speculating in shares on the Johannesburg stock market. Respondent had also entered into an arrangement with the London firm whereby the latter purchased and sold shares on his behalf on the London stock market. The purpose of such dealing in shares was to make a profit on the resale thereof. The deals were financed by moneys remitted to the London firm by respondent and by moneys

advanced on interest by the London firm. The London firm also charged respondent the brokerage, stamp duties and transfer fees normally chargeable in London on all transactions effected on his behalf. The purchases and sales of the shares were effected by the London firm in London where the shares were paid for, held and delivered and where the proceeds were received. In the majority of cases transactions in London were only affected after the London firm had discussed the matter with respondent in the course of telephone calls relating to the arbitrage business jointly transacted by the two firms, but, in accordance with the arrangements between it and the respondent, the London firm was entitled to deal in shares on his account without his authorization.

During the tax year in question respondent made a net profit of £1,694 on the share dealings in London and during the same time made a net profit of £2,808 by speculation on the Johannesburg market.

In assessing respondent for income tax and super tax the Commissioner included the sum of £1,694 in respondent's income. To this assessment respondent objected and, upon his objection being overruled, appealed on the grounds:

(i) That, inasmuch as the business giving rise to the income was carried on wholly in London with the consequence that the source of the income was outside the Union, the income did not form part of his taxable income;

(ii) that, alternatively, if the transactions formed part of a business carried on by respondent in the Union, such business extended to a country outside the Union and there should therefore be an apportionment in terms of section 17 of Act 31 of 1941.

It was held by the Special Court, upholding the appeal upon the first of these grounds, that the basic and real reason, or originating cause, for the receipt of the income was the buying and selling of the shares, which took place in London, and that, therefore, the income consisting of the profit on such sales was derived from a source located in London.

On appeal by the Commissioner directly to the Appellate Division:

Held, dismissing the appeal, with costs, that the Special Court in considering the 'basic and real reason' for the receipt of the income, as compared with the 'dominant cause', had not shown a failure to appreciate the meaning of the word 'source' as applied to such a situation;

Held, further, that it could not be shown that on the facts the only true and reasonable conclusion was that the dominant or main or substantial or real and basic cause of the accrual of income was to be found in Johannesburg;

Held, further, that a reasonable person could conclude that a distinct business of buying and selling shares was being conducted by respondent in London and that, despite the fact the authorization for and confirmation of such deals were given in Johannesburg, the real or dominant source of the income was the use of respondent's capital in London and the making and executing of the contracts in London.

W.G. Trollip, Q.C. (with him *C.J.M. Nathan*), for the appellant: South African law, unlike the English law, does not regard the place where the contracts are concluded as necessarily the source of the location of the profits. See *C.I.R. v Epstein*, 1954(3) S.A. 689;1 *Millin v C.I.R.*, 1928 A.D. 207;2 *Overseas Trust Corp., Ltd. v C.I.R.*, 1926 A.D. 444;3 *Kerguelen Sealing & Whaling Co., Ltd. v C.I.R.*, 1939 A.D. 487;4 *Rhodesia Metals, Ltd.* (*in liquidation*) *v C. of T.*, 1938 A.D. at 291-2.5 The English

rule, applied in such cases as *Lovell & Christmas, Ltd. v C. of T.*, [1908] A.C. at 52, and *Grainger & Son v Gough*, [1896] A.C. 325, is an artificial one adopted for the sake of convenience or *ex necessitate*. The reason is that the courts there are concerned to determine where the trade giving rise to the income is being carried on. In South Africa, the inquiry is as to the source of the profit. See *Overseas Trust* case, *supra*, and *Epstein's* case, *supra*, at 697-8. The true test in South Africa is what is the originating cause giving rise to the income and where did the respondent exercise the activities giving rise to the profits? See *Epstein's* case, *supra*, at 698-9; *C.I.R. v Lever Bros. & another*, 1946 A.D. 450;6 *Millin's* case, *supra*, at 216. The originating cause in the present case was the decision made by respondent in Johannesburg to buy or to sell. Even where no express authority was given at the time but respondent subsequently ratified the transaction, the position is the same. *Omnis ratihabitio retrotrahitur et mandato priori aequiparitur*; see e.g. *Peak Lode G.M. Co., Ltd. v Union Government*, 1932 TPD at 50. Respondent's decision in each instance to buy or to sell was the *fons et origo* of the cause of the profits. The actual purchase or sale in each case was a purely mechanical or automatic part of the transaction. The London agent was a mere conduit pipe as contrasted with the position where his mandate was to buy and sell on his own authority and responsibility. The position in the present case is the same as if respondent had been a member of the London Stock Exchange himself and done his own buying and selling from Johannesburg. The present case is indistinguishable in principle from *Millin's* case, *supra*. If respondent had not done the work in the Union of bringing his mind to bear on the question whether he should buy or sell and he had not given instructions accordingly, he could not have made any profits. Respondent's profits from his dealings on the London Stock Exchange are no different in principle from the profits on the arbitage transactions on which, admittedly, respondent and his firm were taxable. In so far as *I.T. Case* 382, 9 SATC 439, relied upon by the court *a quo*, is at variance with *Epstein's* case, *supra*, and *Millin's* case, *supra*, which was not referred to in *I.T. Case* No 382, it was wrongly decided. *I.T. Case* 560, 13 SATC 308, has no application to the present case. The distinguishing feature is that in the present case there was a course of business operated from Johannesburg in buying and selling and 'playing the market'.

R.S. Welsh, for the respondent: In so far as it is respondent's business to deal in shares on his own account, that business extends to a country beyond the Union within the meaning of section 17 of Act 31 of 1941, since he carries on business as a share-dealer not only in the Union but also in England through his London agents. See *Overseas Trust Corp., Ltd. v C.I.R.*, 1926 A.D. at 454-5, 458;7 *Lovell & Christmas, Ltd. v C. of T.*, [1908] A.C. at 51-2; *Firestone Tyre & Rubber Co., Ltd. v Lewellin* (*Inspector of Taxes*), [1956] 1 All E.R. 693; [1957] 1 All E.R. 561; *Union Government*

v. J.T. Rennie & Sons, 45 N.L.R. 235; *Rhodesia Railways & others v C. of T.*, 1925 A.D. at 445-6, 461-4, 465-6.8 Respondent is therefore entitled at the very least to an apportionment of his total net profits in terms of the first part of section 17; see *I.T. Case* 81, 3 SATC at 139. To dismiss as unimportant the facts that all the shares were bought, sold, held, delivered and paid for in London, that the capital which was used to finance the dealings was wholly employed in London and that all the profits were realized in London, is contrary to the principles laid down in *C. of T. v William Dunn & Co., Ltd.*, 1918 A.D. at 614-15; *Overseas Trust* case, *supra*. The decision in that case would have been different had the taxpayer carried on part of its business in Germany by buying and selling shares there (see especially at 458, per Solomon, J.A.). In the present case respondent carried on part of his shareholding business in London by buying and selling shares there. Appellant's argument overlooks the fact that a man may carry on business in more places than one and in places where he has no residence, and it ignores the distinction between the general business of a person and his other profitable business transactions, which may, or may not, form part of his main or general business; see *Rhodesia Metals, Ltd.* (*in liquidation*) *v C. of T.*, 1938 A.D. at 290.9 Appellant's argument wrongly assumes that the source of a taxpayer's income must necessarily be some activity on the part of the taxpayer himself. Even when income is the result of personal activity, such activity need not necessarily be that of the taxpayer himself, as where the income-bearing operations are carried on by his agents. See *Boyd v C.I.R.*, 1951(3) S.A. at 533;10 *Lamb v C.I.R.*, 1955(1) S.A. at 278, 280, 28211 and cf. *C.I.R. v Lever Bros. & another*, 1946 A.D. at 458;12 *C.I.R. v Epstein*, 1954(3) S.A. at 699, 700.13 In *Millin v C.I.R.*, 1928 A.D. 207,14 this Court did not depart from the principles laid down in the *Dunn & Co.* and *Overseas Trust*, cases, both *supra*. On the contrary, it reaffirmed the principle that in determining the source of the income of 'an ordinary business based upon capital', regard must be had to the place where the capital which produced the profits is employed. See *Millin's* case, *supra*, at 215. On the facts, *Millin's* case is distinguishable; cf. *I.T. Case* 170, 5 SATC 164. The test is not, as contended for appellant, whether, if respondent had not done the work in the Union of bringing his mind to bear on the question whether he should buy or sell the shares, he would have made any profits; see the *Lovell & Christmas, Ltd.*, case, ibid.; *Boyd's* case, *supra*, at 534; *I.T. Case* 826 (1956, April, Spec. Ct. (T)), not yet reported.[15] 'Source' means the immediate source. The immediate source of the profits which accrued to respondent was the sale in London of shares, which the London brokers had bought in London after their value in the London market had risen. The mere fact that before most of the transactions were

concluded the London brokers discussed them with respondent, does not mean that the profits were derived from a source within the Union. The mere fact that the ultimate direction or control of business operations in country 'A' is exercised by a person in country 'B' does not necessarily mean, as a matter of law, that the income produced by those operations is derived from the source in country 'B'; cf. *I.T. Case* 81, 3 SATC 136; *I.T. Case* 382, 9 SATC 439; the *Rhodesia Metals, Ltd*. case, *supra*, at 290-1; 1940 A.C. at 788, 789, 790. If the Special Court's finding that it was the business of share-dealing in London and not the exertions of respondent in Johannesburg which resulted in a profit, is correct, the finding of the Special Court is a finding of fact which cannot be disturbed by this Court unless the 'true and only reasonable conclusion' is that the Special Court drew the wrong inference from the proved facts.

The evidence does not warrant such conclusion. cf. *Morrison v C.I.R.*, 1950(2) S.A. at 455-7;[16] *Edwards v Bairstow & another*, [1956] A.C. 14; *C.I.R. v Strathmore Exploration & Management, Ltd.*, 1956(1) S.A. at 598-9;[17] *Durban North Traders, Ltd. v C.I.R.*, 1956(4) S.A. at 601-3.[18] There is a vital difference between respondent's profits from his dealings on the London Stock Exchange and the profits derived from his firm from its arbitrage business. The essence of the latter was a joint venture which involved successive dealings in the same shares by the London firm in London and by respondent's firm in Johannesburg, the object being to take advantage of a difference in the price of the same shares at the same time in the two markets. Respondent's firm had to employ capital in Johannesburg to finance its part of these operations. The essence of respondent's dealings, on the other hand, was the purchase of shares in London and the sale of the same shares in London at a later date, the object being to take advantage of the enhancement in value of those shares in the London market. Respondent employed no capital in Johannesburg to finance these operations.

Trollip, Q.C., in reply.

Cur. adv. vult.

Postea (13th June).

SCHREINER ACJ: This is an appeal by way of a case stated, under section 81 of Act 31 of 1941, by the Special Income Tax Court, the parties having duly consented to the appeal being brought direct to this Court. The appellant is the Commissioner for Inland Revenue, the respondent taxpayer having succeeded before the Special Court in having his assessment for income tax for the year ended 30th June, 1954, amended by the excision therefrom of an amount of £1,694, received by the respondent from share-dealings in London.

It appears from the special case that the facts proved or admitted included the following:

The respondent lives in Johannesburg and carries on the business of a stockbroker there in partnership with two other persons. He is not, and as a member of the Johannesburg Stock Exchange cannot be, a member of the London Stock Exchange. The respondent's firm does not job in shares on its own account save that it carries on arbitrage business on joint account with a firm of London brokers who are members of the London Stock Exchange and whom I shall call 'the London firm' Arbitrage forms a large part of the respondent's firm's business; the firm's share of profits is returned for Union tax purposes and the partners are taxed thereon. Since July, 1953, the respondent has had in the firm's books, in addition to his 'Capital and Drawings Account', a 'Speculation Account' to which have been debited or credited any speculative deals in shares carried out by the respondent. In July, 1953, the respondent sent £7,000 to the London firm to enable them to deal on his behalf in shares on the London Stock Exchange; his intention was not to acquire shares for dividends but to make a profit on the resale of shares. His reasons for dealing in London were:

(a) London was the leader in share market operations.

(b) The London firm often possessed knowledge not available to the respondent.

(c) London credit facilities were easier than in South Africa.

(d) Stockbrokers in London do not pay tax on profits arising from share-dealing.

(e) If the respondent were to make money on London share-dealings, he would, he believed, not be liable to pay Union income tax thereon.

The remittance of £7,000 originated from certain discussions the respondent had had in South Africa with a partner in the London firm on a visit of that partner to Johannesburg. During that visit the respondent authorized the London firm to deal in shares on his behalf without reference to him, but in effect this did not happen since the two firms were in daily communication by telephone, and it was thus easy to refer matters to the respondent. The remittance of £7,000 made to London did not cover the respondent's purchases, it having been understood that the London firm would give him such credit facilities as might be necessary. The London firm charged the respondent interest on overdraft facilities and brokerage, stamp duties and transfer fees normally chargeable in London on all transactions effected on his behalf. The overdraft as at 30th June, 1954, stood at £4,674. The purchases and sales of the shares were effected by the London firm in London where the shares were paid for, held and delivered and where the proceeds were received. From these London share-dealings the respondent made a net profit in the tax

year of £1,694. The respondent and the London firm exchanged what knowledge they had about particular shares and in general the respondent accepted the London firm's advice in so far as both London and Union transactions were concerned. In the majority of cases transactions in London were only effected after the London firm had discussed the sale or purchase (as the case might be) with the respondent over the telephone during the course of their normal telephone calls relative to the arbitrage business of the two firms. In regard to the purchases of shares in two London companies the London firm bought them for the respondent in anticipation that he would want them; when the London firm told him that it had bought the shares he confirmed the purchases. As from July, 1953, the respondent bought and sold shares on speculative account in Johannesburg and made a profit in the tax year of £2,808. On occasions the respondent was concurrently dealing in shares in the same companies in Johannesburg and through the London firm in London. Some of the Johannesburg transactions were the result of information given to the respondent by the London firm.

The Commissioner having included the sum of £1,694 in the respondent's income and assessed him for income tax and super tax, the respondent objected and, on the objection being overruled, appealed to the Special Income Tax Court. The grounds of objection and appeal that were persisted in were:

1 That the business giving rise to the income was carried on wholly in London, and that consequently the source of the income was outside the Union, so that it did not form part of the respondent's taxable income.

2 Alternatively, that if the transactions formed part of a business carried on by the respondent in the Union such business extended to a country outside the Union and there should therefore be apportionment in terms of section 17 of Act 31 of 1941.

The Special Court upheld the first of these two objections, holding that the income was derived from a source outside the Union.

The issue before the Special Court arose out of the definition of 'gross income' in section 7 of the Act which, so far as material, reads,

'the total amount . . . received by . . . any person . . . from any source within the Union'.

The question before this Court is whether the decision of the Special Court was erroneous in law, in terms of section 81. To resolve this question some portion of the judgment of the Special Court must be quoted. The judgment pointed out that the courts had refrained from laying down rigid tests as to where income has its source, and went on to say that a test which might be a good one in deciding whether income from services has a source within the Union might be useless in deciding that question in relation to income from the employment of capital. There followed a quotation, from the judgment of Watermeyer, C.J., in *Commissioner for*

Inland Revenue v Lever Bros. & another, 1946 A.D. 441 at 450,[19] of the statement 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'.

The judgment then proceeds:

'In the view of the Court the originating cause of income accruing to the appellant' (now the respondent) 'in respect of his share-dealings in London was the fact that he had those dealings and the dealings themselves. The several factors which go to make up the reason why he received an income may not all be located in one place but it seems to the Court that the basic and real reason why he received an income was the fact that he did buy and sell shares in London. His first step in sending money to London in order to support the transactions originated in South Africa, but nothing could be done until the money was in London. In many of the transactions the actual decision in the form of a "yes" or "no" as to whether to buy or to sell shares may have come from Johannesburg; but the sale which resulted from such a decision and as a result of which a profit might accrue took place in London. In the circumstances this Court has come to the conclusion that the real source was the carrying out of the transactions in London and that that source was located in London.'

Later the judgment adds:

'In the present case, although the appellant', i.e. the respondent, 'may have on many occasions given a final answer from Johannesburg and although he incidentally at the same time did carry on similar share transactions in Johannesburg, the business of share-dealing in London was what gave rise to the particular profits in question in this appeal. It was the transactions and not his "exertions" which resulted in a profit.'

The argument for the Commissioner was twofold. It was contended, firstly, that the Special Court erred in not presenting to itself the proper problem, namely, what was the dominant cause of the accrual of the income and the location of that cause; and secondly, that, to follow the language of Lord Radcliffe in *Edwards, Inspector of Taxes v Bairstow*, [1956] A.C. 14 at 35 and 36, 'the true and only reasonable conclusion on the facts found' was that the dominant cause of the accrual was the decisions made by the respondent in Johannesburg.

The first contention raises the question whether the Special Court properly understood the meaning of the word 'source' in the present connection. If indeed it erred in that respect it would be an error of law.

There is no definition of 'source' in the Act and the Special Court was correct in stating that in no case, certainly in this Court, has such a definition been attempted. But the decisions do give some indication of the kinds of tests, factors or considerations that should, according to the circumstances, be used when deciding where the source of the income was. The present case was one in which a profit was gained, on balance, by a series of transactions of purchase and sale. Together they constituted a business in which all parts of the productive transactions were carried out and all the respondent's capital, cash and credit, was used in London, though the final control was with the respondent in Johannesburg. It was unquestionably right to inquire, as the Special Court did, where the business was carried on that brought in the profit. We are not concerned here with a case where that which is sold in one country has been acquired in another, nor with a case where the place of delivery or the place of payment differs from the place where the contracts of purchase and sale were made. Here everything was done in London, except the authorization or confirmation of the transactions, which was in each case given by the respondent in Johannesburg speaking over the telephone to the London firm in London. The Special Court did not lose sight of what was done in Johannesburg in connection with the transactions but concluded that 'the basic and real reason' why the respondent received the income was the purchase and sale of the shares. It was argued for the Commissioner that the language of the judgment shows that, though there were different causes or causal factors, the Special Court had not sought for the dominant causes of the income's being received and had thus shown that it did not appreciate the meaning of the word 'source' as applied to such a situation. I do not agree with this contention. No special virtue resides in the use of any particular word such as 'dominant'. The Special Court used the expression 'the basic and real reason', which showed no less clearly, I think, than 'dominant' would have done that the importance of the various factors was being weighed for the purpose of locating the source. That approach discloses no error in law.

But the Commissioner would be entitled to succeed in this appeal if he could show that the only true and reasonable conclusion on the facts found was that the dominant, or main or substantial or real and basic cause of the accrual of income was to be found in Johannesburg. Now I can imagine circumstances in which, although at first sight it might seem that a distinct business of buying and selling shares in London was being carried on, the transactions there were really only part of a Johannesburg business. The purchases and sales in London might, I apprehend, be so linked up with similar transactions in Johannesburg as to lead to the view that there was only one business located where the taxpayer was personally controlling operations. But the facts found in this case do not show that this conclusion was the only right one. A reasonable person could certainly reach the conclusion, as the Special Court in effect did, that there was a distinct business of buying and selling shares in London, and that the fact that the respondent was a stockbroker carrying on a similar business in

Johannesburg was at most a factor which facilitated the carrying on of his London business.

If there was a distinct business of buying and selling shares in London it cannot be said that because of the factor of authorization or confirmation the true and only reasonable conclusion was that the cause of the accrual of the income was that factor. No doubt the element of control over the transactions may be of importance, depending on the circumstances of the particular case. Here the respondent had the right to terminate the authority of the London firm to buy and sell shares for him, but until he did so they could effectively deal on his behalf without reference to him. The fact that in practice this was only done in connection with the shares of the two companies mentioned above does not mean that there was any change in the terms on which the business was being conducted. I mention this factor, not in order to suggest that it must or should have carried decisive weight with the Special Court but as illustrating the difficulty, indeed the impossibility, of holding that the only true and reasonable conclusion is that the exercise of his control by the respondent in Johannesburg was the cause of the accrual of income. At least another reasonable conclusion which could not be said to be untrue was that the main, the real, the dominant, the substantial source of the income was the use of the respondent's capital in London and the making and executing of the contracts in London.

We were referred by counsel for the Commissioner to the case of *Commissioner for Inland Revenue v Epstein*, 1954(3) S.A. 689 (A.D.),[20] but in that case, apart from the fact that the asbestos was acquired in South Africa for sale in the Argentine, it was pointed out in the judgment of Centlivres, C.J., at 689 that Epstein carried on business in Johannesburg and rendered no services and spent no money outside the Union in connection with his association with the Argentine firm; all of his activities were carried on in the Union and 'it was as a result of these activities that he earned the profits'. From this view it followed that the only true and reasonable conclusion was that the profits were received from a source within the Union. Clearly the facts in that case were in many important respects very different from those of the present case.

Section 17 of Act 31 of 1941 provides for apportionment where the business of a person extends to a country outside the Union. It was, I think rightly, not contended on behalf of the Commissioner that the elements of control and of the association between the London and Johannesburg businesses of the respondent sufficed to bring the section into operation. The respondent only relied upon the section in the alternative, should his main contention fail, and since in my view the latter succeeds it is unnecessary to investigate the scope of the section. The appeal is dismissed with costs.

STEYN, J.A., REYNOLDS, J.A., MALAN, J.A., and PRICE, A.J.A., concurred.

Footnotes

1 19 SATC 221.
2 3 SATC 170.
3 2 SATC 71.
4 10 SATC 363.
5 9 SATC 363.
6 14 SATC 1.
7 2 SATC 71.
8 1 SATC 133.
9 9 SATC 363.
10 17 SATC 366.
11 20 SATC 1.
12 14 SATC 1.
13 19 SATC 221.
14 3 SATC 170.
15 21 SATC 189.
16 16 SATC 377.
17 20 SATC 375.
18 21 SATC 85.
19 14 SATC 1.
20 19 SATC 221.