

Ochberg v CIR: No “benefit” to the benefactor

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ABSTRACT

This article analyses the South African case of *Ochberg v CIR*, which dealt with the question whether shares issued by a company to Ochberg, who was, for all intents and purposes, the sole shareholder, in consideration for services rendered and an asset provided to the company, constituted “income” in terms of the definition of “gross income” in section 7(1) of the Income Tax Act No. 40 of 1925 (as it then applied). Ochberg’s contention was that he had received no benefit from the additional shares issued as the value of all the shares issued had been the same both before and after the issue of the shares. Accordingly, there had been no increase in his wealth and thus no income had been received. The majority decision (two of the five judges dissenting) of the Appellate Division of the Supreme Court held that the shares were “income” and had to be valued at their nominal value. The article first provides a glimpse into the life of Isaac Ochberg, who was a substantial benefactor to charitable causes. It then presents a thematic analysis of the four separate judgments set down in the case, and finally, discusses certain tax principles arising from the judgments. In conclusion, the article considers to what extent Ochberg benefited from the transaction in terms of the Haig-Simons model of taxation and the economic reality of the transaction. The lasting value of the decision is demonstrated with reference to citations of *Ochberg v CIR* in a number of more recent landmark cases.

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“[T]he presence or absence of a benefit to the taxpayer from something that passes into his possession does not provide a proper test in applying the definition of ‘gross income’.”¹

Apart from the present case, *Ochberg v CIR*,² to be discussed in this article, Isaac Ochberg was also involved in a case before the Cape Provincial Division two years later (December 1932) that dealt with the valuation of accruals and a scheme of profitmaking.³ He appeared once more in court, albeit posthumously, when his executors attempted to exclude his wife from his estate on the basis that he had not been married in community of property.⁴ The CIR, ironically, joined forces with the executors in the court action agreeing with the executors’ contention that the Ochbergs had not been married in community of property. This court action was lost by the executors of Ochberg’s case which meant that the CIR also lost their case. However, it was the case of *Ochberg v CIR* (discussed in this article) that was to make tax history.

The period relevant to the court case – the 1926/27 year of assessment – and the year the decision was made known (April 1931), spans an era of economic crisis that is still referred to as *The Great Depression*, that purportedly started with the 1929 stock market crash in New York. However, uncertainty about this historic event is evident from the following extract from a poem by William T. White:

... What made Humpty Dumpty fall?
Nobody knows for certain at all;
Some say the cause was the stock market crash,
And the call which the brokers sent out for more cash,
While others say Humpty had started to fall,
Before the crash and before the call,
But nobody knows for certain at all.⁵

1 Roos, J.A., in *Ochberg v CIR*, 5 SATC 93 at 107.

2 5 SATC 93.

3 *Ochberg v CIR*, 6 SATC 1.

4 *Ochberg v Estate Ochberg and CIR*, 11 SATC 294.

5 Anon. 2009. *News from 1930*.

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The focus of this article is on the judgment in *Ochberg v CIR*⁶ (referred to hereafter as “the *Ochberg* case”). The Commissioner for Inland Revenue taxed Ochberg on shares issued to him by a private company (in which he already owned almost 100% of the shares). Ochberg’s argument, in essence, was that no benefit could accrue to him as he already owned almost all the shares in the company. The objective of this article is to discuss the relevance of various arguments raised in relation to whether or not Ochberg “benefited” from the transaction and in doing so, the following matters will be dealt with:

- an analysis will be presented of the judgments set down in the case, in terms of the following themes:
 - whether Ochberg benefited from the issue of the additional shares;
 - the applicability of the decision in *Commissioner for Inland Revenue v Collins*,⁷ which was relied on by Ochberg;
 - the substance of the transaction, as opposed to its form;
 - the separate legal *personae* of the company and Ochberg;
 - the nature of the consideration received in the form of shares; and
 - the interpretative approach followed by the judges.
- pertinent issues and tax principles flowing from the judgments will be discussed:
 - the concept of beneficial receipt;
 - the subjective *versus* objective debate;
 - the economic reality of the transaction; and
 - the equity of the judgment against Ochberg.

The contribution made by the present article, in addition to the thematic analysis of the judgment (which is a unique method not usually applied to analyse tax cases) and the inclusion of a brief portrait of the protagonist in the case, is the exploration of the relevance of the *Ochberg* decision in relation to accepted principles of a good tax system and subsequent and similar case decisions.

Ochberg: The man and his times

Isaac Ochberg, the eldest son of Aaron and Sarah Ochberg, was born on 31 May 1878 in Uman, a small town in the Ukraine.⁸ In 1894, at the age of 17,⁹ he followed

6 5 SATC 93.

7 1923, A.D. 347.

8 Oranje Orphanage. *Isaac Ochberg*. At <http://ochbergstory.com/the-ochberg-story.html> (accessed 22 August 2013).

9 *Ochberg v Estate Ochberg and Commissioner for Inland Revenue*, 11 SATC 294.

his father to South Africa and settled in Cape Town. A number of years later he established himself as one of Cape Town's leading entrepreneurs with major shipping and property interests and was described as the "plucky ship-owner".¹⁰ In addition to his business interests, he was also actively involved in community affairs and a number of charitable organisations. Ochberg never refused to support a worthy cause. His creed was that, since he had achieved success in the business world, he had a moral obligation to help those less fortunate.¹¹

In the aftermath of the First World War, with famine raging in Russia and Eastern Europe, Ochberg devised a plan to bring homeless Jewish children from these war-ravaged countries to South Africa. A South African Relief Fund for Jewish War Victims was established and Ochberg was instrumental in raising £15 000 for this purpose. He also convinced the then Prime Minister, Jan Smuts, to contribute on a pound-for-pound basis. He personally travelled to Russia and Eastern Europe and returned to Cape Town more than six months later with 167 orphans. One of the orphans remembered him as follows:

"... he was like a father to us. There was no difference from one child to another, every child was a darling, everyone was lovely ...".¹²

Ochberg died in 1937 while on an ocean voyage and was buried in Cape Town. Almost 80 years later, Isaac Ochberg is still remembered in South Africa and abroad. A monument in his honour as a great humanitarian was erected in Israel and a documentary film, entitled *Ochberg's Orphans*: a film by Jon Blair, was released in 2008 to commemorate his heroic deeds. Isaac Ochberg, however, will not be remembered for his humanitarian work alone. He took on the tax authorities on more than one occasion, but failed at each attempt, even posthumously.

The background to and facts of the case¹³ will be set out, followed by a discussion and critical analysis of the judgment.

Background to and facts of the case

Ochberg initially appealed to the Income Tax Special Court against the inclusion in taxable income and the assessment to normal and super tax by the Commissioner¹⁴

10 Boiskin, J. 1994. *The Ochberg Orphans – An Episode in the History of the Cape Jewish Orphanage*. *Jewish Affairs*. Volume 49 (2):21-27.

11 Sandler, S. 2012. *The Ochberg Orphans*. *The Jewish Genealogical Society of Great Britain*. Volume 20 (2):7–8.

12 Slier, L. 2012. *Remembering Isaac Ochberg, Father of Orphans*.

13 5 SATC 93.

14 *Ochberg v President and Members of the Income Tax Special Court*, 4 SATC 227, 1930 at 228.

in respect of three issues. Only the first issue is relevant to the present article, namely shares issued to him in the Airton Timber Company Ltd in return for the cession to the company of a lease with the South African Railways and for financial services to be provided to the company.

The appeal to the Special Court was dismissed and the court found that the three items had all been correctly assessed by the Commissioner for Inland Revenue.

Ochberg, dissatisfied with the decision as being erroneous in law, appealed the decision to the Cape Provincial Division of the Supreme Court. In respect of the issue relevant to the present article, the question was whether the issue of the shares constituted income. The Cape Provincial Division referred the matter back to the Special Court for further information.¹⁵ The Appellate Division focused only on questions of law arising from the facts as set out in the judgment of the Special Court.

Airton Timber Company had a nominal (authorised) share capital of £10 000 made up of 9 950 shares of £1 each and 1 000 1s shares. Prior to the transaction in question, Ochberg had held all but six of the 5 107 issued shares, the other six being held by “subordinates” and family members. During the year of assessment, Ochberg had entered into a contract with the company and the Memorandum of Agreement had been lodged with the Registrar of Deeds as required by the then Companies Act¹⁶ to provide, in exchange for the remainder of the unissued shares (4 843 fully paid up £1 shares and 1 000 1s shares), the following to the company:

- (i) the cession of a lease held by him with the South African Railways for land suitable for a siding and a receiving site for timber;
- (ii) financial assistance to be rendered to the company in connection with certain shipments of timber; and
- (iii) the appellant’s goodwill relating to the continued pledge of his credit on behalf of the company.¹⁷

The Commissioner assessed Ochberg on an amount of £4 893, being the face value of the shares (£4 843 in respect of the £1 shares and £50 in respect of the 1 000 1s shares). Ochberg contested the assessment on the grounds that the shares did not constitute *income* in terms of the Income Tax Act.¹⁸ Even though the value of the shares (£4 893) might appear to be insignificant in today’s terms, a two-week first-

15 5 SATC 93 at 95.

16 Section 92 of Act 2 of 1892 (Cape).

17 5 SATC 93 at 94.

18 40 of 1925

class trip on board a Union Castle ocean liner from Cape Town to England¹⁹ at that time cost £90 and a Studebaker motor car²⁰ £375.

The Special Court held that, as the company and the appellant were separate *personae*, the agreement was a real and substantial contract between the two parties in terms of which the appellant received the shares partly as consideration for the right of occupation of leased premises²¹ and partly for rendering financial services (part of his business as a financier).

In his judgment, Roos, J.A. confirmed²² that the contentions of the appellant before the Special Court were as follows:

- the shares had been received as a gift to himself from the one-man company controlled by the appellant;
- alternatively: if he had received them for value they did not constitute income;

and the recorded judgment of the Special Court indicated that the contention before that court was that there was no substance to the agreement and the transaction evidenced by this agreement was a fictitious one.

In the Appellate Division, Ochberg based his argument on the following:

- before the transaction he had held all but six of the shares and that he had been in full control of the company;
- the further issue of shares had given him no benefit that he did not already have and that, at most, the six £1 shares held by the other shareholders would shrink to about half of their value in proportion to his increased holding and to this extent he had only benefited by £3.

Each of these arguments was addressed by one or more of the Appellate Division judges, and will be discussed below.

“Gross income”, as it was defined at the time of the transaction, was set out in section 7(1) of the Income Tax Act,²³ and included in a taxpayer’s gross income:

“the total amount whether in cash or otherwise received by or accrued to or in favour of any person, other than receipts or accruals of a capital nature ...”.

19 *Huisgenoot*. 3 April 1931 Deel XV No 470, page 12.

20 *Huisgenoot*. 10 April 1931 Deel XV No 471, page 38.

21 “Income” under section 7(1)(d) of the Act.

22 5 SATC 93 at 106.

23 40 of 1925.

The judgments

The decision of the court, to the extent relevant to this article, was set out as follows:²⁴

“Held, ... by a majority (Wessels and Stratford, J.A. dissenting) that the value of the shares received by appellant from the Airton Timber Co., Ltd., was on the facts as disclosed by the statement of the Special Court, income in the hands of the appellant.

Commissioner for Inland Revenue v Collins (1923, A.D. 347), distinguished.

The following facts were not disputed by the appellant:²⁵

- that the shares were received;
- the value attributed to the shares (the par value);
- that the shares were for services rendered and as remuneration for the use or occupation of premises; and
- if the shares had been received by any other person, the receipt would be income and not a receipt or accrual of a capital nature.

De Villiers, C.J. in his judgment concluded²⁶ that “[t]hey [the shares] would clearly fall under income unless for some valid reason they can be said to be receipts or accruals of a capital nature”, and that this appeared to conclude the matter.

Four sets of grounds for the judgment were prepared and reported: the judgment of De Villiers, C.J., Roos, J.A. (Curlewis J.A. concurring) and the dissenting judgments of Wessels, J.A. and Stratford, J.A. Each of the reported judgments differed in certain important respects and each dealt with all or certain of the issues raised by the appellant. An analysis of the judgments revealed the following pertinent issues addressed by the judges: the benefit received; the reliance placed by Ochberg on the decision of *Commissioner for Inland Revenue v Collins*;²⁷ the substance of the contract and its alleged fictitious nature; the separate legal *persona* of the company; the nature of the shares received as consideration for the services provided to the company; and the question of the intention of the legislature. These issues provided the framework for the thematic analysis of the judgments, comparing and contrasting the views of the judges on each issue.

24 5 SATC 93 at 97.

25 5 SATC 93, as reported at 98 and 105.

26 *Supra* at 98.

27 1923, A.D. 347.

The benefit received

De Villiers C.J. questioned²⁸ why, if there was no benefit, Ochberg had entered into the contract and had given valuable consideration for the shares. With regard to the argument that he (Ochberg) had formerly held almost 100% of the issued share capital of £5 000 and after the issue of the additional shares still held almost 100% of the shares (and therefore obtained no benefit), De Villiers, C.J. countered that argument by saying that Ochberg could have disposed of the additional shares in the open market. Furthermore, “the company was presumably enriched to the value of £5 000 by the services rendered and the lease and upon liquidation the assets to be divided would have been less by £5 000”, had the agreement not been entered into. He concluded²⁹ that “[t]he court need not therefore enquire whether he actually was benefited ... of that he is the best judge” and³⁰ “[w]hat repercussions the receipt of that income may have on the rest of his property does not matter”.

In relation to whether or not Ochberg had benefited from the transaction, Roos, J.A., in his assenting judgment, stated³¹ that this was not the test, thus echoing the conclusion of De Villiers, C.J. Roos, J.A. continued to argue that if that was the test, it was in any case clear that he had benefited because the company no longer had the power to assign the shares to a person other than Ochberg. Roos, J.A. also responded to the appellant’s argument that if he had benefited at all it would have been to the extent of £3, being the dilution in value of the shares of the other shareholders. He questioned³² at what point the appellant would have become liable to tax where he had held most but not all of the issued shares prior to the agreement – if the other shareholders held £100 or £1 000? – and, if so, what the benefit would have amounted to. He concluded that if benefit is an element, then the moment it is shown that there is a benefit, Ochberg would be liable to income tax on the undisputed value of the shares.

Roos, J.A also concluded³³ that the deductions provided for in the Income Tax Act do not affect the case and “if the transaction stands alone, it is impossible to urge that it does not fall under the Act.”

28 5 SATC 93 at 99.

29 5 SATC 93 at 99.

30 *Supra* at 100.

31 *Supra* at 107.

32 *Supra*.

33 *Supra* at 106.

Stratford, J.A., in his dissenting judgment, concluded:³⁴ “I can find nothing in the Act which compels us to designate as income something which every principle of reason and common sense tells us is nothing of the kind.”

Commissioner for Inland Revenue v Collins

Reliance was placed by Ochberg on the decision in *Commissioner for Inland Revenue v Collins*³⁵ (referred to hereafter as “the *Collins* case”), where profits were capitalised and bonus shares issued to existing shareholders strictly *pro rata* their existing shareholding and by virtue of that shareholding (emphasis added). The decision in that case³⁶ was that “the shares so distributed were ‘receipts or accruals of a capital nature’ in terms of Section 6 of Act 41 of 1917 and were not assessable for supertax ...”. De Villiers, C.J. considered³⁷ that there was a “vast difference” between the *Collins* case and Ochberg’s transaction; whereas in that earlier case, profits had been capitalised and bonus shares issued to each individual shareholder in proportion to his existing holding, in the present case “the shares were issued for services rendered, just as they would have been issued to any outsider”.

Roos, J.A. argued,³⁸ firstly, that after the issue of the shares to Ochberg, the Airton Timber Company no longer had the power to issue the shares (to other persons) and therefore the issue of the additional shares to Ochberg had value; that differentiated the present case from the *Collins* case. Secondly, in the *Collins* case, if the company had first distributed a dividend and then entered into agreements with the shareholders to take up the shares, the dividends would have been subject to tax. Presumably his argument was that because Ochberg had given value for the shares issued to him and they were not simply a bonus issue out of accumulated profits, the shares constituted income. Thirdly, the interest of a shareholder in the company is capital, but in the *Collins* case there was a consequent dilution in the value of each share, the logical conclusion therefore being that the shareholders had not benefited. Finally, the capitalised profit out of which the bonus issue had been made remained the property of the company, subject to the business risks that might wipe out the whole investment; Roos, J.A. therefore appeared to reason that the shareholders had consequently not benefited from the bonus issue.

34 *Supra* at 119.

35 1923, A.D. 347.

36 5 SATC 93 at 108.

37 *Supra* at 100.

38 *Supra* at 107–108.

Stratford, J.A.'s opposing view³⁹ was that the decision in the *Collins* was “directly in point ... if the issue is made strictly proportionate to existing shareholdings” (which essentially the issue of shares to Ochberg was). He confirmed that the bonus shares in the *Collins* case had been issued in proportion to the existing shareholding and “it was by regard to the *position of each shareholder before and after* the issue ... that the conclusion was reached in England, America and in this Court that such shareholder did not receive any income”. Ochberg had raised this contention in relation to his position before and after the issue to him of the shares, and clearly Stratford, J.A. agreed with his argument.

The substance of the transaction

The contention was made by Ochberg (as stated in the Special Court decision) that there was no substance to the agreement and the transaction evidenced by the agreement was a fictitious one. De Villiers, C.J. referred⁴⁰ to the *Collins* case, where the question turned on whether a dividend had been declared or whether profits had been capitalised. He concluded that the consideration of the substance of the transaction in that case was relevant. He agreed⁴¹

“that the court may look at the substance of a transaction, but this argument must be employed with judgment, more especially in company law [where] the law endows a company with fictitious personality and [it] remains a juristic person separate and distinct from the person who may own all the shares ... To say that a company sustains a separate *persona* and yet in the same breath argue that in substance the person holding all the shares is the company is an attempt to have it both ways.”

Regarding the alleged fictitious nature of the contract, Roos, J.A. responded⁴² that it seemed to him “impossible to hold that a contract of this nature solemnly registered under s 97 of Act 25 can be regarded as fictitious ... Full effect must be given to it ...”. With reference to the decision in the *Collins* case, he also stated⁴³ that “having regard to the very truth of the matter and not the form”, the shareholders in that case had received “nothing that answers the definition of income”.

Stratford, J.A., however, stated⁴⁴ that the choice lies between regarding the issue apart from the position of the recipient of the shares and the material worth to him

39 5 SATC 93 at 116.

40 *Supra* at 101.

41 *Supra*.

42 *Supra* at 106.

43 *Supra* at 108.

44 *Supra* at 119.

and looking at the real nature of the issue and its value to him. Wessels, J.A. agreed⁴⁵ with Stratford, J.A.’s reasoning and conclusion, and stated⁴⁶ that “we must not look at the form of the transaction but at its real nature”. He continued⁴⁷ to reason that “[i]t was never the intention of the legislature to take away from a person part of his estate because he is fictitiously supposed to have received a sum of money. Fictitious income is not gross income.”

The separate legal persona of a company

Ochberg’s contention before the Special Court was that the shares had been received from a one-man company that he controlled. The essence of this argument was that he and the company were to be regarded as one, and for that reason, he had received no benefit from the issue of the additional shares.

Roos, J.A. refers⁴⁸ to the contention that it is necessary to consider the relationship between the appellant and the company, and if the relationship is considered, the appellant “in truth obtains nothing under the contract”. He reasoned⁴⁹ that “[i]t may be that it was a foolish agreement to enter into ... but that does not alter the fact of the transaction”. He compares the position of a person other than the appellant entering into the same agreement and concludes by posing the question: “How can the appellant merely because he stands in a special position towards the company” avoid liability for tax?

Stratford, J.A., however, states⁵⁰ that “[i]f we are compelled in law to shut our eyes to the real substance of the transaction and regard only the receipt of the shares divorced from the position of the recipient in relation to the company, then the solution, although harshly unjust, is simple and adverse to the appellant”. His dissension from the majority decision clearly indicates that he does not consider only the form of the transaction but also takes into account the relationship between the appellant and the company, by⁵¹ “looking at the real nature of the issue”.

Wessels, J.A.⁵² enters into a discussion about share transactions (“juggling with shares in a private company”) entered into in order to “evade the income tax laws”. He agrees that courts should insist on the principle that the individual who controls the

45 *Supra* at 111.

46 *Supra* at 112.

47 5 SATC 93 at 113.

48 *Supra* at 107.

49 *Supra*.

50 *Supra* at 115.

51 5 SATC 93 at 119.

52 *Supra* at 111.

company should not be regarded as the company, but that it should not be assumed in the present case that “juggling with shares has taken place”. He concludes⁵³ that “it would be incorrect to say that Ochberg is the company, but nothing can alter the fact that the assets of the company are all his and the shares held by him merely show how much of the assets would, upon liquidation, form part of his estate”.

The nature of the shares received as consideration

De Villiers, C.J. succinctly summarised⁵⁴ the question whether the shares had been received as capital: “I am at a loss to understand how what is income if received by A for services rendered can be said to have changed its nature into capital when received by B, equally for services rendered.” He continued,⁵⁵ stating that it is irrelevant whether and to what extent a person has benefited and this cannot convert what is income into capital – which is the only ground on which to exclude a receipt from gross income. In relation to the claim that as a result of the issue of the additional shares the value of the existing shares decreased, he concluded⁵⁶ that “[w]hat repercussions the receipt of that income may have on the rest of his property does not matter”. In response to the contention that Ochberg may have benefited to the extent of £3, he also stated⁵⁷ that “[i]t cannot be contended that £3 of the receipt was income and £4 890 was of a capital nature ... [this is] foredoomed to failure”.

Stratford, J.A., however, concluded⁵⁸ that “[t]he accrual is of a capital nature since it is only obtained by a corresponding diminution of capital previously possessed”. Wessels, J.A. argued⁵⁹ that if it is assumed that the taxpayer possesses nothing other than his interest in the company, he will have to realise capital in order to pay the tax on the value of the shares issued to him. He therefore denies that the shares are income in nature.

The intention of the legislature

Over the decades, courts have applied many different approaches of interpreting statutory provisions. The point of departure is usually the “strict and literal” approach of which the underlying assumption⁶⁰ is that the written statutory language

53 *Supra* at 113.

54 *Supra* at 98.

55 *Supra*.

56 *Supra* at 100.

57 *Supra*.

58 5 SATC 93 at 119.

59 *Supra* at 113.

60 Du Plessis, L. 2002. *Re-interpretation of Statutes* at 93.

is a reliable expression of the legislative intent. According to this approach,⁶¹ “the grammatical and ordinary sense of the words is to be adhered to. This approach does not take into account justice, equity or fairness as it follows the letter of the law strictly”,⁶² looking “at what is clearly said. There is no room for intendment. There is no equity about tax.”⁶³ In this regard Wessels, J.A. initially states⁶⁴ that “the court is not concerned with the fairness or unfairness of the impost”. Furthermore, De Villiers, C.J., in relation to whether or not the fact that a person has benefited, can change the nature of a receipt into capital, concluded as follows:⁶⁵ “That may be a reason for the legislature to alter the law but cannot affect our decision [a]s long as the law is what it is ...”. This seems to indicate that De Villiers adopted a strict and literal interpretation of the Act in drawing his conclusion.

At the time of the judgment, however, South Africa was a “parliamentary state in which Parliament reigned supreme”.⁶⁶ Subsequent to the advent of the Constitution,⁶⁷ the judiciary had virtually been compelled to follow a purposive approach to the interpretation of statutes whereby the purpose underlying the statute is sought.⁶⁸ This means that the judiciary do not merely seek the “intention of Parliament”, but also consider the history of the provision, its broad objectives, the constitutional values underlying it and its interrelationship with other provisions. Goldswain submits that possibly the majority decision in the Ochberg case would have been different had the purposive approach been used. He contends that the minority decisions are more in line with the “purposive” approach.

In his minority decision, Wessels, J.A. states the following: “I cannot conceive that the legislature ever intended that the State should take away a portion of a man’s capital ... when the sum total of his assets after the so-called receipt is exactly the same as before” and a taxpayer being obliged to realise his capital in order to pay his income tax “... seems to me to be contrary to the whole tenor of the Act”. This view was based on the preamble to the Income Tax Act read together with the definition of “gross income” that the objective of the statute was to tax only income and not

61 Lord Wensleydale in *Pearson Grey vs Pearson*, [1856] 6 HL Cas 61 All ER.

62 Goldswain, G.K. 2008. The Purposive Approach to the Interpretation of Fiscal Legislation—the Winds of Change. 16(2) *Meditari* at 119.

63 *Cape Brandy Syndicate v IRC* 1921 (1) KB 64 at 71.

64 Du Plessis, L. 2002. *Re-interpretation of Statutes* at 112.

65 5 SATC 93 at 99.

66 Croome, B.J. 2010. *Taxpayers’ Rights in South Africa* at 4.

67 The Constitution of the Republic of South Africa, 1996.

68 Goldswain, G.K. 2012. Hanged by a Comma, Groping in the Dark and Holy Cows – Fingerprinting the Judicial Aids used in the Interpretation of Fiscal Statutes. 16(3) *Southern African Business Review* at 31.

capital. These remarks of Wessels, J.A., it is submitted, are indicative of a purposive approach to the interpretation of statutes.

The preamble to a statute, after all, gives an idea of the main object or “purpose” of a statute. In *Law Union and Rock Insurance Co Ltd v Carmichael’s Executor*,⁶⁹ it was stated: “A preamble has been described by an old English Judge as ‘a key to open the minds of the makers of the Act and the mischief which they intended to redress.’” The court also held that “where the Court is satisfied that the Legislature must have intended to limit in some way the wide language used, then it is proper to have recourse to the preamble”.

Summary of the grounds for the majority decision

Roos J.A., in concluding⁷⁰ that the *Collins* case did not govern the *Ochberg* case and could not be extended to cover its facts, provided a summary of the reasons for his conclusion, which is also a useful summary of the grounds for the majority decision. He argued⁷¹ that the shares are an amount “in cash or otherwise”, they are given for services rendered and the cession of a lease, they have value (and Ochberg himself recorded a value for the shares in his books), the contract between Ochberg and the company is a valid one, they were not received as capital but as ordinary remuneration for services provided and the cession of the lease, and finally, that if Ochberg could prove that a special relationship existed between himself and the company and therefore that when he received the asset his prior shareholding was reduced to 50 percent of its value, he could not, in any event, set off the shrinkage in the capital value of his shares against his taxable income.

An analysis of issues pertinent to the judgments

A number of pertinent issues are revealed by the judgments: the concept of *benefit* as a tax determinant; the objective *versus* subjective debate; the economic reality of the transaction; and the equity of the judgment against Ochberg, in the light of the Haig-Simons model of taxation;⁷² and the precepts of a good tax system,

69 1917 AD 593 at 597.

70 5 SATC 93 at 109.

71 *Supra*.

72 Robert M. Haig, 1921 *The Concept of Income—Economic and Legal Aspects*, in *The Federal Income Tax 1* (Robert M. Haig ed.), reprinted in *Am. Ec. Ass’n, Readings in the Economics of Taxation 54* (Richard A. Musgrave & Carl Shoup eds., 1959); Henry C. Simons, 1938. *Personal Income Taxation 50*.

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as postulated by Adam Smith⁷³ in his *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776).

The concept of benefit as a tax determinant

In his appeal, Ochberg relied on the fact that he had not derived any benefit from the transaction and the concept of “benefit” was referred to in all four judgments in the *Ochberg* case. De Villiers, C.J. remarked⁷⁴ that the court “need not ... enquire whether he actually was benefited ... of that he is the best judge.” In a later case, *CIR v Genn & Co (Pty) Ltd*,⁷⁵ Schreiner, J.A. concluded⁷⁶ that “the presence or absence of a benefit to the taxpayer of something that passes into his possession does not provide a proper test in applying the definition of ‘gross income’ ”.

Regarding the words “received by or accrued to or in favour of” in the definition of “gross income”⁷⁷, Williams states⁷⁸ that “an amount is not ‘received by’ a taxpayer, nor does an amount ‘accrue’ to him unless it is received by the taxpayer on his own behalf and for his own benefit” (emphasis added). The cases he refers to in his analysis of the phrase (including *Geldenhuis v CIR*⁷⁹ and *Pyott Ltd v CIR*⁸⁰) relate to amounts received by the taxpayer on behalf of another or amounts received that may be refundable at a later stage. More recent cases such as *MP Finance Group CC (in liquidation) v C:SARS*⁸¹ also deal with amounts received that are refundable. Other cases, including *CIR v Witwatersrand Association of Racing Clubs*,⁸² deal with the disposal of income after its receipt by the taxpayer. None of these circumstances apply in the *Ochberg* case, and it is submitted that it is irrelevant whether or not a taxpayer has benefited economically from a receipt or accrual, or whether an asset received in return for some performance on the part of the taxpayer later turns out to be of no value to the taxpayer. Taking into account only the receipt by Ochberg of the shares (and not the fact that he gave up an asset that he held in his personal capacity – the valuable lease and services) and the conclusions of De Villiers, C.J. and Roos, J.A., it is clear that he did benefit.

73 Encyclopaedia Britannica. 1987. *Adam Smith. Macropaedia. Volume 27 at 308.*

74 5 SATC 93 at 99.

75 20 SATC 113.

76 *Supra* at 123.

77 S 1 of the Income Tax Act, No. 58 of 1962, which is the same wording as in s 7(1) of the Income Tax Act, No 40 of 1925.

78 Williams, R.C. 2005. *Income Tax in South Africa. Cases and Materials. (2nd Ed.)* Durban: LexisNexis at 102.

79 14 SATC 419.

80 13 SATC 121.

81 69 SATC 141.

82 23 SATC 380.

The objective versus subjective debate

The objective *versus* subjective debate is usually associated with the method of valuation of an asset received by a taxpayer in a form other than cash, and the *Ochberg* decision is often quoted in support of the objective approach.⁸³

Goldswain considers the judgment in the *Ochberg* case whereby the value of the shares was valued objectively rather than subjectively, taking into account that the taxpayer's wealth had not increased at all, to be "patently unfair".⁸⁴ He supports the views of the judges who gave the dissenting minority judgments and suggests that their judgments are in accordance with the "purposive" approach to interpreting statutes in terms of the Constitution of South Africa.

The subjective approach is aptly illustrated in the decision in *Stander v CIR*⁸⁵ and the objective approach in *C:SARS v Brummeria Renaissance (Pty) Ltd*.⁸⁶ In the former case, the taxpayer, Stander, was awarded an overseas trip as a prize by Delta Motor Corporation (Pty) Ltd for being adjudged one of the top five bookkeepers of the franchise dealers. The Commissioner assessed Stander in the amount of R14 000, being the value of the prize. It was held, *inter alia*, that the prize was not an "amount" as the taxpayer could not convert it into money. Thus, although the prize had an objective value, its subjective value to Stander was nil. In *C:SARS v Brummeria Renaissance (Pty) Ltd*, the Supreme Court of Appeal held (on the facts of the particular case) that the value of the right to retain and use borrowed funds interest free constituted an "amount" and that the value of this right, determined on an objective basis, must be included in the income of the respondent. The court rejected the principle applied in *Stander v CIR* that if something could not be converted into money, that it was not an "amount" for the purposes of "gross income". The objective/subjective debate appears therefore to have been finally decided by the Supreme Court of Appeal, in favour of an objective approach to the valuation of an amount. However, it may be questioned whether the method of establishing the objective value was truly determined as the majority decision merely determined that the value of the shares issued was its nominal value.

The economic reality of the transaction

In his judgment, Wessels, J.A. suggested⁸⁷ that the purpose of tax is as follows: "The principle which underlies the Income Tax Act is that the State takes a percentage

83 For example, Williams at 95.

84 Goldswain at 110.

85 59 SATC 212.

86 60 SATC 205.

87 5 SATC 93 at 112.

of the moneys or money’s value which has accrued to the taxpayer during the year of assessment” and that “what the Act intends to tax is income”. Ochberg’s claim was that the shares given to him were not “income” as he already held almost all of the issued share capital and all that the new issue of shares meant was that he still held almost all of the shares. His argument appears to be based on the fact that the diminution in value of the shares he had formerly held was off-set by the value of the new shares; the economic reality of the transaction was that he had gained nothing as a result.

It is submitted that the judges also considered the economic reality of the transaction. De Villiers, C.J. appeared to deny the need to consider the economic reality of the transaction when he stated⁸⁸ that it was irrelevant whether and to what extent a person benefited and⁸⁹ the repercussions of the receipt on the rest of his property did not matter. Roos, J.A. considered⁹⁰ that the deductions provided for in the Income Tax Act do not affect the case. Stratford, J.A., however, was of the view⁹¹ that the real nature of the issue of the shares must be looked at and its value to him – thus the economic reality of the issues of the shares.

The reason why the decision in the *Ochberg* case did not fully reflect the economic reality of the transaction in the hands of the taxpayer was that the courts did not (and could not, as this was not contended by Ochberg) consider the fact that Ochberg had parted with a valuable asset (the right to the lease of the property). As the (full) value of the shares was included in his income, he was poorer to the extent of the value of the lease. Ochberg could not, however, argue that in reality whatever proportion of the shares relating to the services he provided to the company was anything other than income.

The economic reality reasoning can be applied equally to the decision in *C:SARS v Brummeria Renaissance (Pty) Ltd* as in that case the interest-free loans were granted to the taxpayer as a *quid pro quo* for the granting by the company of the right to rent-free occupation of units in the retirement villages. Again the court did not (and could not, as this argument was not raised by the defendant) consider that the economic reality of the transactions was that the company gained only to the extent that the value of the right to the interest-free loans exceeded the value of the rent-free occupation of the units owned by the company (if it indeed did).

88 *Supra* at 98.

89 *Supra* at 100.

90 *Supra* at 106.

91 *Supra* at 119.

One other aspect of the *Ochberg* decision that can be questioned is why the granting to Airton Timber Company of the lease to the property was considered to be “income”. It appears that what Ochberg granted was the right to lease the property, which it is submitted is a right of a capital nature (it formed part of the income earning structure of the company⁹² and provided an enduring benefit to the company⁹³). Since the definition of “gross income” as it then stood excluded from its ambit amounts of a capital nature, he should not have been assessed to tax on the proportion of the shares relating to the value of the right. Although Ochberg contended that the shares were of a capital nature, different grounds were put forward for this claim. To that extent also, the decision of the court did not reflect the economic reality of the transaction. If, however, Ochberg had claimed the loss of the right to the lease of the property as a deduction in his personal tax return, economic reality would have been served.

The equity of the judgment

As already discussed, the decision of the court in the *Ochberg* case resulted in Ochberg being placed in an inequitable economic position. Fairness or equity is a requirement of a good tax system, as postulated by Adam Smith in his *Inquiry into the Nature and Causes of the Wealth of Nations* (1776),⁹⁴ and its continued relevance in modern times is echoed by Williams.⁹⁵

Wessels, J.A.⁹⁶ expressed the view that if Ochberg’s interest in this company had been his only possession, he would have had to sell some shares to be able to pay his tax. This argument seems to imply that, as he was not enriched by the issue of shares (he already owned almost all of the shares in the company), his estate would have been impoverished by the tax payable. On this precept, Ochberg would appear to have been unfairly taxed.

The Haig-Simons model of taxation is advanced in the literature as a tax that would be simple, fair and efficient. Weisbach⁹⁷ states that the Haig-Simons definition of taxation is generally viewed as the ideal tax model. The Haig-Simons definition of taxation is based on the understanding that a taxpayer’s income in each tax period is equal to consumption plus the change in wealth for the period.⁹⁸ Change in wealth

92 *New State Areas v CIR*, 14 SATC 155.

93 *British Insulated & Helsby Cables v Atherton*, [1926] AC 205.

94 Encyclopaedia Britannica. 1987. *Adam Smith. Macropaedia. Volume 27 at 308.*

95 Williams, R.C. 2006. *Income Tax in South Africa. Law and practice. Durban: LexisNexis Butterworths at 3.*

96 5 SATC 93 at 113.

97 Weisbach, D.A. 1999-2000. *A Partial Mark-to-Market Tax System. Tax Law Review at 53.*

98 Robert M. Haig, 1921 *The Concept of Income—Economic and Legal Aspects*, in *The Federal Income Tax 1* (Robert M. Haig ed.), reprinted in *Am. Ec. Ass’n, Readings in the Economics of Taxation 54* (Richard A. Musgrave & Carl Shoup eds., 1959); Henry C. Simons, 1938. *Personal Income Taxation at 50.*

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is based on the change in value of a taxpayer’s assets plus any cash received, or is based on comprehensive income, which is the sum of a person’s annual consumption expenditures and the increment in that person’s net worth in a given year.

“Whether income is an accurate measure of taxpaying ability depends on how income is defined. The only definition that has been found to be completely consistent and free from anomalies and capricious results is ‘accrued income’, which is the money value of the goods and services consumed by the taxpayer plus or minus any change in net worth during a given period of time.”⁹⁹

At the time of the *Ochberg* case, increments in a person’s net worth in the form of capital receipts were not subject to tax – they were specifically excluded from the definition of “gross income” – and to that extent the South African tax system did not comply with the Haig-Simons ideal tax model. If, based on the South African tax system in force at the time, *Ochberg* had been taxed on what could be argued was a capital receipt, while this would be fair in terms of the Haig-Simons tax model, it would not have been fair in terms of the South African tax model.

Conclusion

This article has analysed the judgment in *Ochberg v CIR*, where shares in the company were issued to the appellant in exchange for services to be rendered to the company and an asset transferred to the company. The dispute arose because the appellant, *Ochberg*, was taxed on the nominal value of the shares issued to him, while he was an almost 100% shareholder of the company both before and after the issue of the shares. He argued that he had, as a result, gained no benefit as his share of the assets of the company had remained the same. The case was decided in favour of the Commissioner by three of the judges, with two judges dissenting. The main principle the court had to decide on was whether the value of the shares issued to *Ochberg* constituted “income” and thus fell within the definition of “gross income”. Based on a number of differing grounds raised by De Villiers, C.J. and Roos, J.A. it was held that the shares did constitute income. The contrasting views presented by the five judges are an indication of the complex nature of the problem.

The unique contribution made by this article lies in the thematic analysis of the four judgments and the discussion of pertinent issues arising from the case. The use of a thematic analysis process to compare and contrast the complex arguments of the four judges represents a departure from the usual mode of analysing court decisions.

⁹⁹ Encyclopaedia Britannica. 2013. *The meaning of income*.

Six main themes and the contrasting views expressed by the judges were identified in the analysis of the judgments in the case:

- whether a benefit was received by Ochberg;
- the validity of the reliance placed by the appellant on the decision in *Commissioner for Inland Revenue v Collins*;
- the true substance of the transaction;
- the separate legal *persona* of the company and the effect of this on the taxability of the shares;
- the capital or revenue nature of the shares themselves; and
- indications that certain judges had applied either the strict literal approach to the interpretation of fiscal legislation or the purposive approach.

The four contrasting judgments also presented an opportunity to discuss pertinent issues relating to general principles of taxation. These pertinent issues were:

- the requirement that a taxpayer should enjoy a benefit, in order to be taxed on an amount;
- the subjective *versus* objective debate in relation to the valuation of an “amount” for the purposes of the definition of “gross income”;
- the economic reality of the Ochberg transaction; and
- the equity of the decision in the *Ochberg* case in terms of Adam Smith’s precepts of an equitable tax system and the Haig-Simons theory of taxation.

This article concluded that Ochberg did indeed obtain a partial benefit from the transaction, but only in relation to the services he rendered to the company. The granting of the right to a valuable lease could be interpreted as a receipt of a capital nature, which would not be included in “gross income” or in taxable income in terms of the legislation as it was then.

The fact that the decision in the *Ochberg* case has made a lasting contribution to tax law is indicated by the number of times various aspects of the decision have been cited with approval in later court decisions, including *CIR v Butcher Brothers (Pty) Ltd*,¹⁰⁰ *Mooi v SIR*,¹⁰¹ *CIR v Visser*,¹⁰² *Elandsheuwel Farming (Edms) Bpk v SBI*¹⁰³ and *Hicklin v SIR*,¹⁰⁴ each of which was a landmark case in its own right.

100 13 SATC 21.

101 34 SATC 1.

102 8 SATC 271.

103 30 SATC 163.

104 1980 (1) SA 481 (A).

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