ASSESSSED LOSSES

The trade and income from trade requirements as set out in section 20 of the Income Tax Act of 1962

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in section 20 of the Income Tax Act of 1962

by

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DECLARATION

This project is an original piece of work which is made available for photocopying, and for inter-library loan

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Date ..............................................
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SUMMARY

Section 20 of the Income Tax Act, No 58 of 1962 allows a taxpayer that incurs an assessed loss to carry forward the balance of assessed loss incurred, to be set off against taxable income earned in or added to losses incurred in future years.

The issues regarding the carry forward of assessed losses in terms of section 20 is complex and in terms of the said section, a company is only entitled to set off its assessed loss from the previous year against its taxable income in the current year, if the taxpayer has carried on a trade during the current year and has derived income from that trade.

Under the provisions of section 20(2A), a taxpayer other than a company can utilise an assessed loss even if no trading has been conducted. Assessed losses of natural persons, may however be ring-fenced.

The aim of this treatise was twofold. Firstly it was to gain clarity on the ‘trade’ and ‘income from trade’ issues and secondly to compare South African legislation with that of Australia, with a view to recommending a change in our rules regarding the treatment of assessed losses in the context of companies.

The critical lessons to be learned from the cases presented, is that liquidators, creditors and others must ensure that the company continues trading in order to
keep the assessed losses valid. Realisation of assets (including stock), and the
collection of outstanding debts during liquidation does not constitute the carrying
on of a trade in terms of s 20(1).

The continuity of trade is an important element in regard to the carry forward of
assessed losses to be utilised in the current and future years. Therefore it is
important that a company carries on some activity that falls within the definition of
trade.

In the landmark case of SA Bazaars, it was held that a company did not have to
trade continuously throughout the year to qualify for the set-off of the assessed
loss or carry forward of the assessed loss, that is, to trade for say part of the year.
The court however left open the issue of whether it was necessary to derive
income from that trade.

In order to clarify the issues regarding assessed losses, SARS issued
Interpretation Note 33 granting taxpayers a concession in certain cases where a
company has traded, but not derived income from that trade. But in ITC 1830, the
court ruled that a company must trade and must derive income from that trade in
order to carry forward its assessed loss, which effectively means that SARS cannot
apply Interpretation Note 33. SARS does not have the authority to make
concession which is contrary to the wording of the Act.
In Australia, operating losses can be carried forward indefinitely to be set-off against future income, provided a company meets the more than 50% continuity of ownership test. Where the continuity test fails, losses can be deducted if the same business is carried on in the income year (the same business test).

From the research conducted and in order to solve the issues surrounding the carry forward of assessed losses it was suggested that one of the following be adopted:

- The method used in Australia for the carry forward of assessed losses, or

- A decision of the Supreme Court of Appeal is needed for a departure from the literal meaning of the words pertaining to the requirements regarding the carry forward of assessed losses. Furthermore, to clarify the definition of ‘income’, as used in the context of s20, is it gross income less exempt income or taxable income? If section 20 relates to taxable income, then an assessed loss will never be increased, which it is submitted, is not what the legislature intended. Section 20 ought to be revisited to eliminate any uncertainty about the income requirement and in the context in which the word ‘income’ is used in that section.
Key words

Assessed loss, balanced of assessed loss, trade, income from trade, income, taxable income, commencement of trade, utilisation of assessed losses, carrying on of a business, continuity of ownership test, control test, same business test, anti-avoidance
CHAPTER 1

“In this world nothing can be said to be certain, except death and taxes.’

- BENJAMIN FRANKLIN, letter to Jean Baptiste Le Roy, Nov. 13, 1789 -

INTRODUCTION

1.1 BACKGROUND

As a general principle, the South African income tax system operates on a strict year-by-year basis, in which a person’s taxable income is determined for each tax year. Taxpayer’s taxable income or assessed loss is calculated with reference to a tax year.

Various authors of journals are of the opinion that ‘income’ was used in its defined sense in the predecessor to s 20(1) while in the latter provisions, not least and only because the qualifying words ‘as defined’ have been omitted, ‘income’ is used in the sense of taxable income, but that also conferring on ‘income’ its defined sense would give rise to various anomalous and absurd implications.
The rules for determining the taxable income of taxpayers may be summarised as follows:-

**GROSS INCOME** (as defined in section 1 of the Income Tax Act) xxx

Less : Exempt income (Section 10 and 10A) (xx)

**INCOME** XXX

Less : Deductions and allowances (Sections 11-19 and 23, mainly) (xxx)

Add : Taxable (portion of ) cash allowances (section 8 (1) and capital gains (section 26A) xxx

XXX

Less : Assessed Loss brought forward if applicable (Section 20) (xxx)

**TAXABLE INCOME OR (ASSESSED LOSS)** XXX

'Taxable income is the amount on which normal tax, at the applicable rate, is calculated. Taxable income is arrived at after setting off the balance of an assessed tax loss brought forward from the previous year. An assessed loss arises when the deductions and allowances exceed the sum of the income and taxable gains. Taxable income cannot be negative. If the deductions exceed the income for the year, the taxpayer will have an assessed loss carried forward to the next year'.

1 K Huxham &P Haupt Notes on South African Tax (2011) in para 1.3
The preamble to section 11, requires

- A trade to be carried on
- Income to be derived from such trade

In the absence of these two conditions, the amounts should ordinarily not qualify for a deduction.

Taxpayers will be considered to have an assessed loss for the year of assessment, if the allowable deductions exceed their income for the year.

It is important to note that the difference between taxable income/assessed loss and profit/loss before tax calculated for accounting purposes, relates to non-taxable, non-deductible and temporary differences.²

If a taxpayer makes a tax loss in year 1, that loss is allowed to be carried forward into the following tax year and the tax years thereafter, until the loss has been fully absorbed by income, provided it is trading and income is earned from that trade.

²Q Voster et al Introduction to IFRS 2ed (2009)at406
Section 20(1) of The Act has two requirements, before an assessed loss may be carried forward, namely that a taxpayer must:

- carry on a trade during the current year of assessment, ('the trade requirement') and
- have derived income from that trade ('the income from trade requirement') during that year of assessment.

The issue as to when trade commences is important, because in some cases it can take several years before a company is in a position to earn income. If the activities in the current year are preliminary to the commencement of trade, the company stands to lose its balance of assessed loss.

Guidance is to be found on the question as to when trade commences in South African case law.

The provisions of section 20(2A) exempts a taxpayer other that a company from the trade requirement, with regard to losses brought forward from a previous year. A natural person's assessed loss may however be ring-fenced.\(^3\)

\(^3\) Section 20A
This is in contrast with the rules applicable to a company. Before a company can carry forward an assessed loss from the previous year of assessment; it must have carried on a trade during the current year of assessment. If it fails to do so, the company will lose its right to carry forward its balance of assessed loss.

In *SA Bazaars v CIR*⁴, the court held that although the company kept itself alive by having a bank account, it closed its business and accordingly did not trade. In ITC 664 (a case heard before SA Bazaars), the court held that there had to be income from trade. Then in ITC 777 (decided after *SA Bazaars*), the court held that even though a company tried to let property without success, it was not allowed to carry forward an assessed loss.

The ‘income from trade requirement’ has attracted much controversy over the years. This important aspect is dealt with in chapter 4.

Due to this controversy, SARS issued an Interpretation Note⁵, to clarify when a company may forfeit the right to carry forward its assessed loss where it has not traded during a year of assessment, or has traded but not derived any income from that trade.

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⁴ 1952 (4) SA 505 (A), 18 SATC 240
The onus (section 82) will always be on the taxpayer to prove that they comply with the requirements as set out in the law.

In ITC 1830\(^6\) decided in 2007, the ‘income from trade requirement’ was the issue before the tax court. The court ruled in this case that the assessed loss could not be carried forward, as no income was earned despite there being trade activity. This contradicts what has been said in the Interpretation Note.

The decision in ITC 1830 creates a possible anomaly, which will be one of the core issues of this treatise.

The taxation rules regulating assessed losses differ from country to country. From the Zimbabwean cases reported in South Africa, it is noted that the principles of assessed losses are similar to that of South Africa.

In Australia, operating losses can be carried forward indefinitely to be offset against taxable income derived during the current and future years. In terms of the Tax Ruling TR 1999/9\(^7\), to carry forward previous years’ losses, a company must meet the more than 50% continuity of ownership test. Where the

\(^6\)(2006) 70 SATC 123
continuity test fails, losses can be deducted if the same business is carried on in the income year (the same business test). The Australian approach is dealt with in more detail in chapter 5.

1.2 RESEARCH GOALS AND AIMS

The aim of this treatise is twofold:-

➢ To gain clarity on the ‘trade’ and ‘income from trade’ issues in relation to s20.
➢ To compare and contrast South African legislation with that of Australia with a view to recommending a change in our rules regarding the treatment of assessed losses in the context of companies.

1.3 RESEARCH PROCEDURE

Research Methodology

In order to achieve the objective of this research, a detailed review and analysis of case law surrounding the requirements of section 20 has been carried out. The following methodology has been used:

➢ A manual and computer search was conducted to identify the relevant cases and other literature required for purposes of this treatise. Information was extracted and analysed from information collated.
➢ A brief comparative study of the legislation and case law of Australia was undertaken.
It must be noted that this treatise deals specifically with the carry forward of assessed losses for companies. A detailed discussion of the carry forward of assessed losses for taxpayers other than companies falls outside the scope of this treatise.

Outline of the treatise

Chapter 1: This chapter provided an introduction to and an outline of the research project. It defines the research problem, giving a better understanding as to the purpose and reason for the research.

Chapter 2: In this chapter a general overview of assessed losses as it applies to a company is presented.

Chapter 3: In this chapter a literature review on the “trade requirement” is presented.

Chapter 4: In this chapter a literature review on the “income from trade requirement” is presented.

Chapter 5: In this chapter a literature review on the assessed losses and the carry forward of assessed losses in Australia is presented.

Chapter 6: This chapter details the conclusions drawn from the research undertaken and recommendations made.
CHAPTER 2
OVERVIEW OF ASSESSED LOSSES IN GENERAL

2.1 INTRODUCTION
The previous chapter gave an outline to the research topic and defined the research problem and the purpose for the research. As mentioned in the previous chapter, this treatise will not consider in any detail the carry forward of assessed losses for taxpayers other than companies. (See 2.3 below). This treatise focuses on events that may prevent the utilisation of the assessed loss by a company. Thus it will be useful to review certain other aspects of assessed losses.

2.2 THE LAW
Section 20(1) of the Act, provides that, when the taxable income derived by a taxpayer from the carrying of any trade is determined, there shall be set off against that income so derived

- any balance of assessed loss incurred by the taxpayer in any previous year, which has been carried forward from the preceding year of assessment; and
- any assessed loss incurred by the taxpayer during the same year of assessment in carrying on any other trade either alone or in partnership with others, otherwise than as a member of a company whose capital is divided into shares.
In terms of the provisions of section 20 (2A), a taxpayer other than a company can still utilise an assessed loss even if no trading has been conducted.

Effectively, section 20(1) has two requirements, before an assessed loss may be carried forward, namely that a taxpayer must:-

- carry on a trade during the current year of assessment (referred to as the ‘trade’ requirement), (discussed in chapter 3) and
- have derived income from that trade during that year of assessment (the ‘income from trade requirement’) (discussed in chapter 4)

### 2.3 ASSESSED LOSSES APPLICABLE TO INDIVIDUALS

For a person to carry forward and set off an assessed loss, section 20 (1) of the Act requires that the person be carrying on a trade.

However section 20 (2A) (a) of the Act permits persons other than companies to carry forward an assessed loss even if no trading has been conducted and section 20 (2A) (b) also allows persons other than companies to carry forward an assessed loss if no income has been derived in the current year of assessment.

The claiming of losses is subject to the provisions of section 20A, the ring-fencing provisions. This section only applies to natural persons whose taxable income (before the setting-off of the loss) falls within the top bracket at which the marginal
rate reaches its maximum. This section was introduced to prevent the perceived abuse of taxpayers reducing their taxable income by claiming losses from hobbies disguised as secondary trades. To provide affected individuals with a better understanding of what ring-fencing entails and also to enable them to determine how and to what extent the provisions may affect their personal income tax liability, SARS has published a guide\(^8\) which sets out how SARS interprets the legislation and provides some practical examples and responses to frequently asked questions.

### 2.4 MEANING OF ‘BALANCE OF ASSESSED LOSS’

A ‘balance of assessed loss’ has not been defined, therefore reliance has been placed on the judgments of numerous tax cases to provide clarity regarding the meaning from which it has been established that it means the excess of any assessed loss that is brought forward from the preceding year.

The methodology for determining a balance of assessed was described by Schreiner ACJ in *CIR v Louis Zinn Organization (Pty) Ltd*\(^9\):

> ‘Wherever there has been a trading loss in the tax year, or where there has been a balance of assessed loss brought forward from the previous year, there has to be a determination of \(\ldots\)

\(^8\) Guide on the Ring-fencing of Assessed Losses arising from certain trades conducted by individuals

\(^9\) 1958 (4) SA (A), 22 SATC 85 at 95
the balance of assessed loss to be carried forward into the next year. There may have been a profit in the tax year but not large enough to obliterate the balance of assessed loss carried forward from the previous year. Then the new balance of assessed loss will be smaller than the previous one. If there has been a working loss in the tax year the balance to go forward will be increased. If there has been no previous balance the assessed loss in the tax year will be the balance of assessed carried forward. The point to keep in mind is that, although at the stage where it is to be used, i.e. when it is to be set off against a profit, a balance of assessed loss looks back to the past, at the stage where it is being determined, i.e. when its amount is being calculated, it looks forward to the future when it will be used. At the determination stage it is being prepared for future use, and it has then no effect on the taxpayer’s liability in respect of the tax year for which the relative notice of assessment is issued.

2.5 COMPARING SOUTH AFRICA V AUSTRALIA WITH REGARD TO ASSESSED LOSSES

The issues surrounding the carry forward of assessed losses in South Africa is complex. In order to explain these issues, SARS issued Interpretation Note 33. The Interpretation Note clarifies the circumstances in which a company may forfeit its right to carry forward its assessed loss from the preceding year of assessment as a result of it not carrying on a trade during the current year, or having carried on a trade but not deriving any income from that trade. It also grants concessions in certain instances where trade has been conducted and no income has been earned from that trade.
It must be noted that the Interpretation Notes that have been issued by SARS, are a means of notifying taxpayers how the Commissioner’s discretion is to be exercised. The Interpretation Notes merely set out SARS’ interpretation of the law and may be challenged by taxpayers who disagree with the particular interpretation. The Interpretation Notes are also not binding on SARS to the extent that they may be rejected by the interpretation of a court, or if they only set out SARS’s view of the meaning of the tax laws.10

In ITC 1830 the court overruled the Interpretation Note; it completely ignored what had been said in the Interpretation Note and held that in order to carry forward an assessed loss, the company has to trade and had to have income from that trade.

Foreign cases have influenced the development of the South African Income Tax system to a major extent.11 However these cases must be cautiously approached as they may be different on certain bases of taxation applicable in foreign countries. However, these precedents would be most valuable and may influence South African courts, especially when they deal with points of law that are similar to that in South Africa.12

10 K Huxham & P Haupt Notes on South African Tax (2011) in para 1.8
11 D Meyerowitz Meyerowitz on Income Tax 2004-2005 The Taxpayer § 3.26
The Australian method of dealing with the carry forward of assessed losses has been reviewed which, it is submitted, appears to be straightforward. A review of the Australian method of dealing with assessed losses is dealt with in chapter 5.

2.6 SECTION 103(2) AND SECTION 20(1) (a)

Sections 20 and 103(2) are complementary: s 20 allows the set-off of an assessed loss against income whilst s103 (2) disallows such set-off in certain circumstances. If there is no income in the year of assessment, or no trade took place, the assessed loss is lost.\(^\text{13}\)

The question to be asked is whether the use of an assessed loss in a scheme for the avoidance of tax may in appropriate circumstances be attacked exclusively under s 103(2)\(^\text{14}\). The answer lies in the case of New Urban Properties v SIR\(^\text{15}\).

‘The principle established in New Urban Properties Ltd v SIR was that if through the operation of s 103(2) a balance of assessed loss incurred by a company is prohibited from being set off against income accruing to the company, that balance of assessed loss may not be carried forward to any subsequent year of assessment and falls away completely. This means that even if a company does

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\(^\text{13}\) SA Bazaars (Pty) Ltd v CIR 1952 (4) SA 505 (A), 18 SATC 240

\(^\text{14}\) J Silke ‘Assessed Losses of Companies ’ (1991) 30 Tax Reporter at 54

\(^\text{15}\) 1966 (1) SA 215 (A), 27 SATC 175
carry on trading during a year in respect of which the Commissioner has successfully invoked s 103(2), this trading will not entitle it to carry forward the balance of assessed loss to the next year of assessment.'\textsuperscript{16}

In the New Urban case, the taxpayer company was registered in 1945 to carry on the business of dealing in land. In the financial year 1948 it entered into bad deals causing huge losses and by the end of the financial year end was insolvent, showing an assessed loss of £767 709, having brought forward an assessed loss of £ 268 000 from the preceding year. For the period 1\textsuperscript{st} July 1958 to 31\textsuperscript{st} December 1958, the company was dormant.

On 1\textsuperscript{st} January 1959, a controlling interest was acquired by five parties who were interested in other land-dealing companies and the reason for acquiring the company was to divert income from their other companies to the appellant company and make use of the accumulated loss of that company to avoid tax on that income.

After the change in shareholding, the appellant company carried out certain business transactions realising income of approximately £5 640. For year of assessment 30 June 1959, company disclosed said income and sought to set off this income against the accumulated loss brought forward from the previous year.

\textsuperscript{16}J Silke ‘Assessed Losses of Companies ’ (1991) 30 Tax Reporter at 55
The Commissioner refused to allow the set-off on the grounds that the income had been received as a direct result of a change in the shareholding of the company, solely or mainly for the purpose of utilising the assessed loss incurred by the company to avoid the liability to pay tax.

It was conceded on behalf of the taxpayer that the income had been received as a result of arrangements effected for the purpose of utilising the assessed loss to avoid liability for tax on that income, but it was claimed that while the balance of assessed loss could not be utilised as a set-off against the income in question, the assessment should show that balance as available for set-off against future income.

After reviewing the SA Bazaars and the Louis Zinn Organization cases, Beyers JA concluded at 13:

‘According to both decisions subsection (3) envisages a continuity in setting off an assessed loss in every year succeeding the year in which it was originally incurred, so that in each succeeding year a balance can be struck to the satisfaction of the Secretary which can then be carried forward from year to year until it is exhausted; if, for any reason, the assessed loss cannot be so set off and balanced in any particular year, there is then no ‘balance of assessed loss’ for that year which (viewed from the succeeding year of assessment) there is no ‘balance of assessed loss which has been carried forward from the preceding year of assessment,’ in other words, the essential continuity has been fatally interrupted. In the S.A.Bazaars case, supra, that interruption occurred through the taxpayer’s ceasing to trade in a particular year. In the present case it has occurred through the operation of section of section 90(1)(b) which prohibited the balance of
assessed loss from being set off against the only income received by the appellant, in respect of
the only trading activities conducted by it, as will appear later. In other words, although the
respective causes of interruption were different, the result under section 11(3) was the same in
each case'.

According to Strachan\textsuperscript{17} for s 103(2) to be applicable, it is necessary that income or
proceeds be received by or accrued to the company. He goes on to say that if the
company trades for a few days in the tax year for the purpose of keeping its
assessed loss alive, it will have to prove that such activity was genuine and not a
tax avoidance scheme and SARS would not be able to permanently disrupt the
assessed loss in terms of s103(2).

2.7 THE ACCOUNTING TREATMENT OF ASSESSED LOSSES

“In terms of IAS 12\textsuperscript{18}, a deferred tax asset is recognised for the carry forward of
unused tax losses and credits to the extent that it is probable that there will be
taxable profit in future against which the unused tax losses and credits may be
utilised. The deferred tax asset represents the income tax amounts that are
recoverable in future periods in respect of :-

- Deductible temporary differences
- The carry forward of unused tax losses; and

\textsuperscript{17} J Strachan ’Those assessed tax losses (2005) South Africa’s corporate legal magazine
\textsuperscript{18} Q Voster et al Introduction fro IFRS2ed(2009)at419-420
➢ The carry forward of unused tax credits.

The deferred tax asset should only be created to the extent that it will be utilised in future by means of taxable temporary differences, or when acceptable evidence exists to indicate that sufficient taxable income is available.\(^{19}\)

In other words a deferred tax asset should only be raised if it is reasonably certain that the company will make profits in the future to utilise the assessed loss.

**2.8 CONCLUSION**

This chapter presented an overview of assessed losses, detailed the requirements for the carry forward of an assessed loss, the relationship between sections s 20(a) and 103(2) and the accounting treatment of assessed losses.

The first requirement for the carry forward of assessed losses for companies, is that the taxpayer has to trade, which is the focus of the next chapter.

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\(^{19}\) Q Voster et al *Introduction to IFRS* 2ed (2009) at 420
CHAPTER 3

ASSESSED LOSSES: THE TRADE REQUIREMENT

3.1 CHARACTERISTICS AND PURPOSE OF TRADE

Section 11(a) of the Act, allows a taxpayer, in the determination of its taxable income derived from carrying on a trade, to deduct any expenditure incurred in the production of income which is not of a capital nature. The remaining general deductions allowable are contained in subsections (bA) to (x) of the section.

It is submitted, that in order to fulfill the requirements of the general deduction formula, it is not necessary to have ‘profit’ in the accounting sense, but the absence of a profit making objective might indicate that the company did not incur a particular expense in the production of income.\textsuperscript{20}

The term ‘trade’ is defined in section 1 of the Act as every profession, trade, business, employment, calling, occupation or venture, including the letting of any property and the use of or the grant of permission to use any patent as defined in the Patents Act, 1978, or any design as defined in the Designed Act, 1993 or any trade make as defined in the Trade Marks Act 193 or any copyright as defined in the Copyright Act 1978 or any other property which is of a similar nature.

\footnote{20 AP De Koker Silke on South African Income Tax in 7.3}
‘In *Burgess v CIR*\(^{21}\) the principle that this definition should be given a wide interpretation was described as being well established. It was also pointed out that the definition is not exhaustive\(^{22}\)

In *ITC 770*\(^{23}\) it was held that this definition should be widely construed and is obviously intended to embrace every profitable activity.

The test to be applied to determine whether the taxpayer indeed traded is an objective one, which, per definition, means that the Commissioner has no discretion in this regard. The moment a company does not carry on a trade in a subsequent year, the assessed loss is forever lost. It is not necessary for the taxpayer to carry on a trade throughout the year following the year in which the assessed loss was incurred. In principle, trading for any period during that year should be sufficient. Each case will be decided on its own merits. It is also not a requirement that the taxpayer conducts the same business in year two as was conducted in year one. The requirement is only that a trade is conducted in year two. However, trading involves an active step and the mere intention to carry out some business activity or a particular transaction is insufficient.\(^{24}\)

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\(^{21}\) 1993 (4) SA 161(A)
\(^{22}\) *Silke* § 7.2
\(^{23}\) 19 SATC 216
\(^{24}\) ITC 1476 52 SATC 141 148
The courts have been called upon, on numerous occasions, to decide whether a company has been ‘trading’ or ‘carrying on a ‘trade’ during the year. This can happen when:

- The nature of the activity itself does not fall within the meaning of the ‘trade’ as defined in section 1 of the act;
- The company’s activities have taken place before the commencement of trade;
- The company conducts non-trade activities after it has ceased trading; or
- The anti-avoidance provisions of section 103(2) of the Act apply.

Silke had the following to say about trade:

‘In spite of its wide meaning, the term trade does not embrace all activities that might produce income, for example in the form of interest, dividends, annuities or pensions’

### 3.2 TRADE AND ASSESSED LOSSES

The courts have interpreted s 20(1) to mean that an assessed loss brought forward from a previous year may only be set off against the taxpayer’s income provided the taxpayer can show that they have traded during the year for which the

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Silke in §7.2
assessed loss is to be utilised\textsuperscript{26}. The trade need not have been conducted for the entire year, it is sufficient that some trade be conducted during the year.

Section 20(1)(a) envisages a continuity in the setting-off of any assessed loss against income in every year succeeding the year in which it was originally occurred, so that the balance of assessed can be determined in each following year until the assessed loss is completed absorbed\textsuperscript{27}.

In order to set off assessed losses, such losses must have been incurred in the carrying on of a trade within the Republic. Thus, if a taxpayer should extend his trading activities outside South Africa, then according to the proviso any losses from that activity must be ring fenced to that operation for set off against income from that operation. The proviso is as follows:

Provided that there shall not be set off against any amount –

(a) distributed......

(b) derived by any person from the carrying on within the Republic of any trade, any-

(i) assessed loss incurred by such person during such year; or

(ii) any balance of assessed loss incurred in any previous year of assessment, in carrying on any trade outside the Republic\textsuperscript{28},

\footnotesize
\textsuperscript{26} Section 82, Burden of proof
\textsuperscript{27} New Urban Properties Ltd v SIR 1966 (1) SA 215 (A), 27 SATC 175
\textsuperscript{28} Section 20 of the Income Tax Act
3.3 THE NEED TO CARRY ON A TRADE

The principles regarding the carry forward of assessed losses have been firmly entrenched in our law by a pioneering case, namely *SA Bazaars (Pty) Ltd v CIR*\(^{29}\).

SA Bazaars (the appellant company) traded as a general dealer. As a result of losses incurred, it closed down its business in November 1941. Although it did not carry on normal trading operations, the appellant still maintained its existence, continued its banking account, obtained transfer of its trading licence to other premises, paid company tax, etc, but did not carry on any normal trading operations.

For the years ending on 30 June 1944 and 1945, SARS permitted the company to carry forward the assessed loss by issuing assessments that reflected losses brought forward. No assessment was issued for 1947.

During June 1948, it resumed active business and the following year it earned a profit from these operations. The CIR, in determining the company’s taxable income, did not allow the balance of assessed loss to be set off against the 1948 years income and issued a NIL assessment for the year. The appellant company objected to the said assessment stating that it is entitled to carry forward year by year the accumulated loss resulting from its trading operations prior to closing of

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\(^{29}\) 1952 (4) SA 505 (A)
operations, and to set such loss off against the profit earned by it on its resumption of active business.

Centlivres CJ, in delivering his judgement, deemed it fit to first decide whether or not the company was entitled to carry forward the assessed loss into the year ending June 1944. This was so because, if the company was not; entitled to carry the loss into the 1944 year, it would not be entitled to the loss in the subsequent years.

The judge said that the mere fact that the company kept the company alive, did not mean that the company was carrying on a trade during those periods. The facts of the case clearly showed that it closed down its business. As long as it kept its business closed it cannot be said to have been carrying on a trade, even though it may have held that it had the intention to resume its trading activities at a future date. The judge found that, during the 1944 year, the appellant did not carry on any trade, and therefore was not entitled to carry the 1943 assessed losses into the 1944 year. The company was therefore not entitled to carry the loss into the subsequent years, and it could not be set off against the 1948 income.
3.4 PLANNING A BUSINESS VENTURE

Amounts disguised as trade income will not be accepted as having been earned from the carrying on a trade. In the case of *SARS v Contour Engineering*\(^3\) the court was required to decide whether the laying of business plans and incurring commission and outlaying minimal expenditure constituted the carrying of a trade.

The taxpayer company conducted business as a steel construction company and after serious difficulties ran into losses and went into liquidation. The CIR had disallowed its assessed loss as it did not trade.

After the liquidation was discharged, it had started to collect its outstanding debts and this required attention to maintenance work and structural faults in contracts which had previously been performed by it. It derived commission from one transaction for the selling of engineering equipment. The court suspected that the amount was fictitious, and refused to allow the amount as being derived from the carrying on a trade.

\(^3\) 1999 (E), 61 SAR at 447
In deciding on whether the taxpayer’s activities did constitute the carrying on of a trade Eksteen JA had the following to say:\footnote{61 SATC 447 at 456}

‘It is clearly correct that a venture must be viewed as a whole and that it may straddle more than one tax year. There is, however a vast difference between the mere laying of plans for the respondent’s future, on the one hand, and the commencement of preparatory activities for a future venture, on the other, as was contemplated in the afore going passage from Robin’s case. At least some activity is required. In my view the mere laying of plans cannot constitute the carrying on of a trade as envisaged in s1 of the Act in the absence of some positive act aimed at promoting the said plans.’

The evidence in the Contour case had clearly established the absence of any proper means of a business operation. The respondent had no premises, no equipment, no stock, no staff and save for book debts, no assets. The Court, with respect, concluded that under the circumstances and based on the facts this was an unmistakable instance indicative of a company which had not been trading.

Interpretation Note 33 was issued by SARS. As mentioned previously, its intention is to clarify the circumstances in which a company may forfeit its right to carry forward its assessed loss from the preceding year of assessment.
As far is the ‘trade requirement’ is concerned the following extracts from Interpretation Note 33 are relevant and have been expanded on where necessary.

3.5 THE ACTIVE STEP REQUIREMENT

Trading involves more that a mere intention to trade.

Interpretation Note 33, refers to ITC 777, in which it was held that the mere intention to let property does not constitute the carrying on of a trade. The active step must comprise more than the mere laying of plans.

In this case the company was registered in 1941 and carried on a manufacturing business. In 1944 it discontinued its business as it was incurring losses. The name of the company was changed, and certain fixed properties and shares were acquired as income-producing investments. For the year ended June 1947, the company had incurred an assessed loss and in the following financial year, company earned dividends and made a profit from the sale of shareholdings.

Furthermore during the 1948 year, the company held fixed property from which no rentals were received, although every attempt to let this property was made. The

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32 Interpretation Note 33 § 4.1.6
33 Interpretation Note 33 at 6
34 19 SATC 320
CIR in assessing the company did not allow the assessed loss to be brought forward to be offset against the 1948 income. The CIR contended that the company had not carried on trade during the year.

Neser, J in coming to his decision considered the following:

- if no trade carried on, it was not entitled to set off its income against the balance of assessed loss brought forward from the previous year
- Although the company sold shares, it was not dealing it shares and as such could not be said to be carrying on a trade
- Investing of monies is not carrying on of a trade
- The mere intention to let property does not amount to carrying on of a trade, something more has to be done.

Neser, J had the following to say

‘The extent of the effort or the amount of money expended cannot, however, be the test whether a company or person was trying to get business. It is sufficient if there was some attempt, even if no money was expended.’

In ITC 1476, the taxpayer company at the end of its 1986 tax year had an assessed loss which it sought to set off against its taxable income in its 1987 tax

\[35\] (1953) 19 SATC 320(T) at 320
\[36\] (1953) 19 SATC 320(T) at 322
year. In that year its income was nil in respect of dividends and R574 in respect of interest. Its capital was invested in shares in property companies and in loan accounts in property companies which were at the time interest free. The interest it earned was from money deposited at the bank.

The CIR disallowed the set-off of the assessed loss brought forward on the ground that the taxpayer had not carried on a trade during its 1987 year of assessment. The case went on appeal and was dismissed on the grounds that the taxpayer was not trading.

The court in delivering its judgement stated that the carrying on of a trade involves an active step, something more than merely watching over existing investments and, as has been said previously, it is not necessary that the company must have carried on a trade for the entire year, any period of trading would suffice.

3.6 COMMENCEMENT OF TRADE

The issue as to when trade commences is important because in some cases it can take several years before a company is in a position to earn income. If the activities in the current year are preliminary to the commencement of trade, the company stands to lose its balance of assessed loss. This could be an issue with the start-up of a new company or the termination by a company

\[37\] (1989) 52 SATC 141
\[38\] Interpretation Note 33 § 4.1.7
of one business while preparing to start another. There is very little guidance to be found on the question as to when trade commences in South African case law.

Decided cases from countries such as America, Australia and The United Kingdom regarding the commencement of trade have been presented in the Interpretation Note\textsuperscript{39}

The only consistent principle that can be extracted from these cases is that the question as to when trade commences must be decided on the facts and circumstances of the particular case.

It is unlikely that a company has commenced trading, if it has no assets with which to trade. In order to carry a loss forward, a company must commence trading during a year of assessment. If it does not commence trading, its expenses have to be capitalised.

Section 11A then allows the company to deduct such capitalised expenses in the year it commences trading – if such expenses would have been deductible had

\textsuperscript{39} Interpretation Note 33 §4.1.7
they been incurred after trading commenced. This would include preparatory expenses.\textsuperscript{40}

3.7 WHEN DOES TRADE CEASE\textsuperscript{41}

Companies in liquidation

In many cases the only income derived by companies in liquidation will be post-liquidation interest. As this will not be ‘income from trade’ the focus switches to activities such as the collection of debts, in order to meet the trade test and achieve a set-off of the balance of assessed loss against the interest income.

3.7.1 Collection of debts

In \textit{Timberfellers (Pty) Ltd v CIR}\textsuperscript{42} the court had to decide whether the collection of its outstanding debts, largely through the agency of a firm of attorneys, by a company with an assessed loss, amounted to the carrying on of a trade. In this case the taxpayer manufactured equipment to harvest timber and sugar milling equipment which it sold in terms of franchise agreements with overseas manufacturers.

\textsuperscript{40}Huxham & Haupt \textit{Notes on South African Tax} (2011) at 271
\textsuperscript{41}\textit{Interpretation Note} 33 § 4.9.1
\textsuperscript{42}1994(N), 59 SATC 153
However, the company ran into financial difficulties and was placed into provisional liquidation in September 1982 which then soon after became final. However, due to a scheme of arrangement under ss 311, the company was discharged of the liquidation on 3rd October 1983.

After the discharge, the company had no assets and no staff, and had lost all its franchises. Its only asset consisted of pre-liquidation debts owed to it and an assessed loss which was dated pre-liquidation.

The question arose concerning the period of the 1984 tax year running from the discharge of the taxpayer from liquidation (5 October 1983) to the end of the tax year 30 June 1984, because in this period the taxpayer had set-off the balance of an assessed loss in an amount of R2m against the income derived by it for that year, which loss had been carried forward from the 1983 year of assessment to the 1984 year of assessment.

The CIR refused to allow the set-off on the basis that it did not carry on ‘trade’ in the 1984 year. The only activity that could remotely look like trading that the taxpayer could prove for the 1984 year was that it had been able to collect much of its pre-liquidation debtors through a firm of attorneys. The proceeds of the collection had been utilised to repay a loan account owing to the main shareholder and not utilised to fund any trading activities of the taxpayer.
The court noted that while the collection of trade debts was an integral part of the transaction giving rise to the debt, this did not mean that the collection itself necessarily amounted to the carrying on of a trade, especially if funds collected were not used for any trading activity and the debts rose from trading activities that took place before the company became dormant. It held that in the circumstances of this case it could not be said that the collection of the debts amounted to the carrying on of a trade and that the company was therefore prohibited from carrying forward its balance of assessed loss.

From the above it can be said that the collection of debts by a collection agency or similar institution can be said to be carrying on a trade. The same could not be said for an individual collecting its own debts.

3.7.2 Trade v Realisation

In the case of *Robin Consolidated Industries Ltd v CIR*[^43] the taxpayer company was a manufacturer, wholesaler and retailer of stationery and associated products operating shops throughout the country through its subsidiary companies.

In this case, the court was called upon to decide whether two sales transactions held during the year constituted the carrying on of a trade.

[^43]: 1997 (3) SA 654 (SCA), 59 SATC 199
In this case, the taxpayer company was put under provisional liquidation in September 1986.

Its creditors thought it more beneficial to sell its business as a going concern and to cease its previous trading activities, but the sale of the business excluded certain stock that was in a bonded warehouse. The buyer of the business undertook to make an offer of compromise, the substance of which was that the buyer would acquire the shares in the company, the original sale would be superseded and the provisional liquidation be set aside.

The compromise was sanctioned by the court on 15 March 1988 but any trading from 1 October 1986 till the acceptance of the compromise was deemed to be for account of the company. It was while the company was in the state of limbo that the company effected two sales of goods in bond. These sales took place in April and July of 1987 and were reflected in the liquidator’s accounts as ‘sale of shipments’.

The CIR in assessing the company for the 1988 year of assessment disallowed the carry forward of the accumulated loss from the 1987 year on the grounds that it had not carried on a trade during 1988.

‘The court held that there had been no trading in the ordinary sense, by the acquisition and holding of stock in the hope of reselling it at a profit while accepting
the risk of loss. Also the stock in bond was not in the company’s possession and
the opportunity was offered to others to make a profit and risk a loss. It was held
then that the company did not trade and could thus not carry forward its assessed
loss. The taxpayer’s alternative argument was that the rule in SA Bazaars was
‘clearly wrong’ and should be departed from. That case and New Urban Properties
Ltd v SIR had enunciated the proposition that set-off against an assessed loss was
admissible only:-

- Against income derived from trade; and
- When the balance of assessed loss has been carried forward from the
  immediately preceding year of assessment’.

Ngalwana, in his critique of the judgements in the Robin and Conshu cases
commented that ‘income’ was used in its defined sense in the predecessor to s
20(1) while in the latter provisions, ‘income’ is used in the sense of taxable income
and also made the point that conferring on ‘income’ its defined sense would give
rise to the anomalous and absurd implications. He further recommends that section
20 of the Income Tax Act should be revisited by the legislature to eliminate any
uncertainty about the income requirement and the context in which the word
‘income’ is used in that section.

The above case illustrates how vital it is to adhere to the requirement that it is necessary for a company to trade in each and every year of assessment in order to preserve an assessed loss.

Swart\textsuperscript{46} contends that an assessed loss from the previous year could therefore be utilised in a later year even though the taxpayer’s activities in that year also resulted in an assessed loss, in which case the respective assessed losses could be added and carried forward to the next year. As authority for this proposition he cites CIR v Louis Zinn Organization in which an allusion to the possibility of an accumulation of assessed losses was made in passing.

The court held in Robin Consolidated (at SA 664, SATC 208) that the sale of the trading stock by the liquidators did not constitute trading but merely realisation\textsuperscript{47}

Robin Consolidated confirms the principle laid down in SA Bazaars in relation to the prerequisites in term of s 20(1) of the Act, for the carrying forward the balance of an assessed loss, for income tax purposes, but held that the taxpayer’s sale of

\textsuperscript{46} GJ Swart ‘The Utilization of Assessed Losses by Companies – A reappraisal after Conshu (Pty) Ltd v Commissioner for Inland Revenue’ (1996)8 \textit{SA Merc LJ} 119 at 125.

trading stock was a mere realisation and not ‘trade’, thereby failing to meet those prerequisites.\footnote{48}

3.7.3 MONEY LENDING COMPANY IN LIQUIDATION

In ITC 1751\footnote{49}, the taxpayer was a company in liquidation. Prior to its liquidation it conducted the business of business investment, trust management and property development but the essence of its trade was as a moneylender, by borrowing and lending to persons engaged in speculative ventures, and earned interest on the money it lent out. As such this money constituted circulating or floating capital as opposed to fixed capital.

Thirteen Liquidation & Distribution accounts had been prepared where post-liquidation income had continuously been set-off against assessed losses in terms of s20.

SARS objected to the 14\textsuperscript{th} Liquidation and Distribution account on the basis that the taxpayer (in liquidation) had not carried on trade, post liquidation, and therefore the assessed loss could not be carried forward.

\footnotetext{(2002) \textit{65 SATC} 294 (C)}
SARS’s view was that the taxpayer had ceased trading on the date it had sold the last property in its portfolio, and that the earning of interest was insufficient to carry on a ‘trade’.

There was an agreement between SARS and the taxpayer’s liquidators to the effect that the taxpayer would be granted pre-liquidation assessed losses and would be able to set-off post-liquidation income against that as long as no s311 scheme is entered into (the “1993 agreement”).

Taxpayer contended that:

- In its hands money was stock-in-trade in that it was a moneylender and that the money was its stock-in-trade or circulating capital no less after liquidation than it had been before liquidation.

- What the liquidators did by way of collecting money owed to taxpayer, a moneylender, constituted the carrying on of a trade as contemplated in s 20(1)(a), and was therefore, entitled to set off its balance of assessed loss against its post-liquidation income.

In delivering his judgement, Davis J had the following to say:\(^{50}\)

"it had employed capital to make loans and thus its capital was of a circulating nature; that is trading-stock. For almost a decade after liquidation it had continued to employ its circulation

\(^{50}\) 65 SATC 394 at 302
capital accordingly. The liquidators were required to allow the circulating capital to be used accordingly and as the management of the appellant had done previously, namely, manage the process by way of collecting the repayment of interest and return of capital.

In my view, appellant was in a similar position to a trader who decides to close his business at a particular point, not acquire future stock but trade until its existing stock was sold. In these circumstances the appellant had for a decade continued to trade as it continued to conduct its business.

It was decided that the collection of outstanding debts, the advancing of loans, and the repayment of loans in the case of a moneylender, constitutes a carrying on of a trade.

3.8 CONCLUSION

In order to carry forward the balance of assessed loss from the immediately preceding period to be offset against the current year’s income, the taxpayer has to be trading.

According to Silke the critical lessons to be learned from the above cases is that the liquidators, creditors and others must be careful to continue trading in order to keep the assessed losses alive. The realisation of assets (including stock) for the liquidation do not constitute the carrying on of a trade. Also the collection of

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outstanding debts to be made available as capital earned before being placed into liquidation, and before disposing of it to third parties, also does not constitute the carrying on of a trade in terms of s 20(1).

According to Temkin\textsuperscript{52}, it is normally difficult to determine whether a company has carried on a trade and that SARS has said in Interpretation Note 33 that it will apply an objective test to determine that a trade has in fact been carried on, but the note did not describe how SARS will carry out that test.

According to Coetzee\textsuperscript{53}, the continuity of trade is an important element with regard to the carry forward of assessed losses. Where a company is hopelessly insolvent, the Appellant Division has held that it is difficult to imagine how it could have traded, then or indeed at any future date.

Thus, if a company wished to preserve its assessed loss, it should ensure that it carries on some activity that falls within the definition of trade.

The second requirement necessary for the carry forward of the assessed loss, namely the ‘income from trade requirement’ will be dealt with in the next chapter.

\textsuperscript{52} S Temkin ‘Sars raises the bar for claims against assessed losses (2005) \textit{Business Day}

\textsuperscript{53} H Coetzee ‘Some aspects of assessed losses taxation’ (1998) 29 \textit{Accountancy SA} 37
CHAPTER 4

ASSESSED LOSSES: THE INCOME FROM TRADE REQUIREMENT

4.1 INTRODUCTION

The second requirement for the carry forward of assessed losses, is that there has to be income from a trade, that has been carried on during the year of assessment (the ‘income from trade requirement’).

The ‘income from trade requirement’ has attracted much controversy over the years and is the focus of this chapter.

The income requirement is only applicable to companies. Under the provisions of section 20(2A)(b), taxpayers other than companies can still utilise an assessed loss even if no income is derived.

4.2 DEBATE CONCERNING THE ‘INCOME FROM TRADE REQUIREMENT

Section 11 (a) of the Act dealing with normal deductions from income requires that income be so derived from trade; however, it has never been a requirement that the income be derived from trade in the same year in which the deduction is
The question to be asked is, why could the assessed loss not be dealt with in such a way, in that it could be set off in future years against income which is derived from trade?55

There are those who argue in favour and those who argue against the 'income from trade' requirement.

'Those that argue in favour of the 'income from trade' requirement refer to the wording of section 20(1), which requires that the assessed loss be set-off against income derived. In other words, if there is no income, then no set-off will be allowed'56.

'Those who argue against the 'income from trade' point to the fact that in terms of section 11(a), it is sufficient for an amount to be allowed as a deduction, if it is incurred to produce income, and it is not necessary that the income be derived in the same year of assessment'57.

54 Sub-Nigel Ltd v CIR for Inland Revenue 1948 (4) SA 580 (A).
55 B Ger 'A little less likely to lose that loss' (2005) 14 De Rebus 42
56 Interpretation Note 33 13
57 Interpretation Note 33 14
The issue whether set-off, or carry forward could take place for a year during which the taxpayer had carried on a trade but had earned no income from the trade has been the subject of several articles in law journals.  

The articles explain the unintended consequences construction companies may face, especially in lean trading periods, where for example, their contracts are structured in a way that they neither receive nor accrue any income before a certificate of completion is issued and other obligations are complied with. Where that company’s activities were limited to that one project for a period exceeding one year, it would have incurred deductible expenditure, which may have been financed by means of bank loans, but no income would have accrued during that period. Should the accrual then take place in year two that company would not be able to claim the losses generated in year one.

Cornelissen explains that the above could not have been the intention of the legislature. He goes further on to say at p53:-

’Whether trade should precede income or vice versa may become a bit of a chicken-and-egg argument. In my view, the decisive requirement is that the taxpayer must have traded during the

59 C Conelissen ‘The Gauteng Tax Court confirms the income from trade requirement’ (2008) 28 De Rebus 53
tax year in question. Whether he earned income from that trade is irrelevant, as long as he had
the intention to derive income therefrom.'

4.3 CASE LAW ON THE ‘INCOME FROM TRADE’ REQUIREMENT
The question whether a taxpayer must actually derive income from that trade
carried on was left open in the ground-breaking case of SA Bazaars (Pty) Ltd v
CIR\(^{60}\). In this case the taxpayer company did not carry on any trading during the
year of assessment and in the absence of the trade requirement, the court found it
unnecessary to deal with the income requirement.

In delivering his judgement, Centivres CJ had the following to say:\(^{61}-\)

‘During the year ending 30\(^{th}\) June, 1944, therefore, the appellant did not carry on, within the
meaning of sec. 11(1), a trade within the Union and it derived no income from that trade. Under
that sub-section a deduction or set-off is admissible only against income derived from carrying
on a trade. As the appellant carried on no trade during the year under consideration it was not
competent for it to set-off in its income tax return for that year the balance of assessed loss
incurred by it in previous years. It is not necessary for the purposes of this case to decide
whether the appellant would have been entitled to set-off that balance in respect of the year
ending 30\(^{th}\) June, 1944, if during that year it had carried on a trade but earned no income.’

\(^{60}\)1952 (4) SA 505 (A)
\(^{61}\)SATC 240 at 245
In ITC 664\textsuperscript{62}, a case decided in 1948, before the SA Bazaars case, the court held that income must have in fact been derived in order to carry forward its assessed loss.

In this case the appellant company traded for some years up to and including the year ended 30 June 1929, in which year of assessment the company ended up having an assessed loss. From that date to June 1945, the company did not derive any income from that trade. From 1930 to 1945, the CIR determined the loss to be NIL. The CIR refused to allow the assessed loss to be carried forward during the years in question. On appeal the CIR’s decision was upheld.

C.J. Ingram, K.C., President had the following to say in delivering his judgement:\textsuperscript{63}-

‘The position, therefore, that transpires is that as long as there is some amount of income in the next succeeding year, however small, there is still room for the set-off and accordingly again a fresh ‘balance of assessed loss’ arrived at, to be carried forward.

‘The next question to be determined is what will be the position if there is no income in the next succeeding year. Here it is important to note that the section operated by way of set-off, i.e., the apposition of one amount against the other. It does not envisage the addition of the ‘balance of assessed loss’ to a loss on the year’s trading or its accumulation therewith. Section 11(1) provides that there shall be set off against the income the amounts permitted under sub-section (3). “It follows, therefore, that in any given year, there must be some income, i.e an amount received in terms of s 7, against which the set-off can operate. Further, the income must be derived from trade. If, therefore, the taxpayer has not traded and has received no income from trade, as in the present case, it cannot invoke the provisions of the section. The same would be

\textsuperscript{62}(1948) 16 SATC 125 (U)
\textsuperscript{63}(1948) 16 SATC 125(U) at 126-127
the case if the taxpayer had relinquished his trade for more than a year and had resumed it at a later stage. Here again he is precluded from setting off a balance of set-off assessed in a previous year, because such loss has not been carried forward from the *preceding year of assessment*.

In ITC 777\(^{64}\), a case decided in 1953, after SA Bazaars, the court on the other hand held that the assessed loss can be carried forward irrespective of whether income was earned. The facts of this case were presented in chapter 3.

Neser, J., President in delivering his judgement had the following to say:\(^{65}\) -

‘As the company had endeavoured to let the property I am of the opinion that it did carry on trade in the year ended 30 June, 1948. It was not contended that the company was not entitled to set off its balance of assessed loss for the year ended 30\(^{th}\) June 1947, merely because it had no income in the year ended 30\(^{th}\) June, 1948.’

In ITC 1679\(^{66}\), a case decided in 1999, the court took the position that ‘income from trade’ was a requirement.

In this case, the taxpayer was a close corporation in the tourism consultancy business. In 1994 it changed its business from a shop to operation as a consultancy for national and international tourists. At the end of the 1994 year of assessment, the corporation had an assessed loss. During the 1995 year of assessment, the corporation had a balance of assessed loss. In 1996 the company claimed a set-off of its assessed loss for the year ended 30 June, 1995.

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\(^{64}\) (1953) 19 SATC 320 (T)
\(^{65}\) (1995) 19 SATC 320 (T) at 322
\(^{66}\) (1999) 62 SATC 294
assessment it generated no income, but incurred expenditure in producing promotional material and in paying for the cost of its sole member to visit the USA with his secretary with the aim of recruiting clients for the business.

Counsel for the appellant argued that the appellant needed to show that it had conducted trade, that is, it needed only to prove the trade requirement. He referred to the conflicting judgements of ITC 664 and ITC 777 and contented that ITC 777 was correctly decided and should be followed.

Counsel for the respondent on the other hand strongly argued that there was a further requirement, in addition to the income requirement, in terms of which the appellant must prove that it also generated income in the relevant year.

'The court quoted from two celebrated judgements in arriving at its decision:-

- New Urban Properties Ltd v SIR, 27 SATC 175 : “In other words, not having traded in that year, and therefore not having earned any income from trade, there was nothing against which the balance of assessed could be set off in that year”.

- Robin Consolidated Industries Ltd v CIR, 59 SATC 1999 :[There is] a series of decisions in this court, which have construed section 20(1) as meaning that if there is no income or loss from trading in a given year the machinery for setting off an assessed loss cannot operate, with the result that the assessed loss disappears'.

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The court then applied these dicta to the facts and found that, because the taxpayer had not derived any income during the 1995 tax year, it was precluded from carrying forward to that year, the assessed loss from 1994.67

In delivering his judgement, President, Musi J said68:

I therefore agree with counsel for the respondent that there is indeed this additional requirement of ‘income from trade’ that the appellant must meet in order that it can bring forward the assessed loss from its 1994 tax year. The only income that the appellant derived in the 1995 tax year is interest amounting to R4 703. That amount, was however, not derived from the appellant's normal trade.’

The difference between companies and persons other than companies is that the Act precludes a company from utilising an assessed loss from a previous year in which it has not carried on any trade as this will interrupt the continuity required for the setting off of such a loss. This requirement is not necessary for individuals wishing to carry forward their assessed losses.

Swart69, discusses the different ground rules applying to companies and to persons other than companies. It raises the constitutional question whether there is a rational policy justification for the present differential between companies and persons other than companies.

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68 (1995) 62 SATC 294 at 299
He had the following to say\textsuperscript{70}

The differential treatment under s 20 of companies and persons other than companies will pass constitutional muster if it is logically and rationally connected to a legitimate governmental purpose it is meant to serve. The only possible explanation for the differential treatment is that it is meant to prevent some abuse regarding the utilisation of an assessed loss from a prior year that is peculiar to companies temporarily suspending their trade for a period exceeding a tax year. It is unclear what this possible abuse might be. It is also unclear why a company should invariably forfeit, under s 20, an assessed loss from a prior year in these circumstances but forfeit it under s 103(2) only if the relevant transact or event is entered into or effected solely or mainly for purposes of tax avoidance. Section 20 ignores any sound commercial reasons for the temporary cessation of a company’s trade. Even the fact that a company might be forced to suspend its trading operations for reasons outside its control, or might consider such suspension necessary for its financial survival, will not prevent the forfeiture of its assessed loss. It is clear that the rational-relationship test for instance of mere differentiation is very limited.....

The lack of any possible rational explanation for the differentiation under s 20 leads one to the conclusion that the differential treatment of companies and persons other than companies ‘is arbitrary or irrational, or manifests naked preferences’ (Jooste supra in par 17) and that it is based on muddled thinking rather than a logical and rational connection to any legitimate governmental purpose......'

The issue left open in the SA Bazaars case (namely that an assessed loss can be set off, where a taxpayer has carried on a trade but earned no income) was the subject of a case in 2005.

\textsuperscript{70}GJ Swart ‘The requirements for the utilization of assessed losses by companies – rational policy or muddled thinking?’ (2001) 13 SA Merchantile Law Journal 464-465
In *SARS v Megs Investments (Pty) Ltd and Another*\(^7\)\(^1\), both taxpayers were affiliated to the same group. They conducted business from the same premises with the same staff. The only difference was that one concentrated its business on retail outlets while the other on wholesale outlets. This business involved the arrangement and management of discounts for a chain of retail and wholesale grocery outlets trading as ‘Sentra Stores’, ‘Megasave’, ‘Value Stores’, ‘Till Late’, ‘Pop 2000’ and ‘Retail Management Group’.

The two respondents sold their business on 1 January 1996 and stopped carrying on their normal trading activities. After receiving the purchase price they invested a part thereof with a bank, receiving interest on that investment. However, various activities were carried out by the respondents which were directed at exploring the possibility of establishing new businesses in other countries. To this end considerable money, time and effort was expended by the directors of the respondents but no contracts were concluded, no organisations was established, no trading was done and no income was earned.

In their 1996 tax returns the respondents sought to set-off the balance of their assessed loss carried forward from the previous year. The Commissioner disallowed such set-off on the ground that the respondents did not carry on any

\(^7\)\(^1\)2005 (4) SA 328 (SCA)
trade and did not generate any income from trade in 1996. In a further appeal to the SCA the Income Tax Special Court, having reversed the Commissioner’s decision, which reversal was confirmed by the High Court, the court held that the respondents had not shown that s20(1) permitted set-off of their assessed loss against interest on investment. It was settled law that in ordinary circumstances income in the form of interest on an investment was not income derived from carrying on a trade within the Act (regarded as passive income).

In delivering his judgement, Jones AJA had the following to say:\textsuperscript{72}

‘Counsel for the respondents submitted that the respondents have discharged the onus of proving the first proposition. He submitted that they have shown that they carried on a trade (which I have accepted) and that they had earned income against which to set off the balance of an assessed loss, i.e. the interest income from investment. He conceded that to succeed they have to overcome the hurdle of showing a connection between the trade they carried on and the income they received. This concession is in effect a concession of the correctness of the argument by the Commissioner that the point left open in the SA Bazaars case – whether set-off can operate if a trade is carried on but no income is derived from it – should be answered in this case in favour of the Commissioner. I think that in the light of the wording of s 20(1) and the wording of s11 (a) of the Act as it then read the concession may have been correctly made. I prefer, however, to say no more on the point. I must make it clear that no argument to the contrary has been placed before us, the point has not been given the consideration which contrary argument would require, and my decision is based on the concession.’

\textsuperscript{72} 66 SATC 175 at 179-180
The question remains unresolved and no binding precedent has been established by the Supreme Court of Appeal.

The issue by SARS of Interpretation note 33⁷³ was intended to guide taxpayers regarding concessions.

In a note to the Interpretation Note, SARS states that it will not disallow a company’s assessed loss when it has genuinely traded but has derived no income from that trade.

It is not an absolute concession, as SARS does caution that in the absence of income from trade, it may indicate that a company has not traded and SARS may still attempt to apply ‘the income from trade’ requirement in cases where the taxpayer has not carried on bona fide trading operations.

The Note also suggests that, in genuine cases of companies that trade, SARS will be unlikely to disallow assessed losses for the mere reason that no income was earned during a particular year of assessment.

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Interpretation Note 33, contained a compromise, in which SARS agreed to allow a company, that can prove that a trade has been carried on during the current year of assessment to set-off the balance of its assessed loss from the preceding year, despite the fact that no income may have accrued from the carrying on of such trade.

Gildenhuys J, ignored the concession granted in the Interpretation Note in ITC 1830 where the taxpayer company traded but did not earn trade income. The court held that the derivation of income from trade is indeed a requirement before an assessed loss may be carried forward in terms of s 20(1).

The taxpayer company in ITC 1830 was a resident company whose primary business was that of awarding of licences to the security industry for the use of a computer programme, the so called ‘CT Programme’. At the end of the 2003 year of assessment the taxpayer had an accumulated assessed loss of approximately R3.3million, made up primarily of development expenditure in respect of the programme. During the 2004 year of assessment, which is the subject-matter of this case, the taxpayer accumulated further losses and received income, consisting mainly of interest and some sundry income, all of which was unrelated to the trading activities.

74 70 SATC 123
SARS disallowed the set-off of the loss on the contention that the taxpayer did not receive any income from trade during the 2004 year of assessment. On appeal to the Tax Court the taxpayer argued, inter-alia, that the accrual of income was not a prerequisite for purposes of carrying forward an assessed loss in terms of s20 of the Act.

Although the case has several issues, the main issue is whether income must have been received or accrued to a taxpayer in a tax year in order for the taxpayer to satisfy the requirements of s20.

It was held that a balance of assessed loss brought forward from a previous year of assessment cannot be set off against a loss in the current year of assessment if there was no income during the current year of assessment.

The judgement in the above case has effectively nullified the purpose and application of Interpretation Note 33 and confirms the requirements of section 20(1).

It was held further that if, despite the anomalies which must follow, the legislature intended in s 20(1) of the Act to require a continuity of trading, it would not be incongruous for the legislature to also require through s 20(1) of the Act that there must be continuity of income. In this regard, the Commissioner in Interpretation...
Note 33, cannot and clearly did not intend to change the law by making concessions to address unintended results.

The judgement in ITC 1830 sets the tone for a questioning look at SARS’ publications on its interpretations and practice, because where there are concessions which now appear to no longer be in favour of the taxpayers, there are sure to be interpretations and practices believed to be in favour of SARS which can now be challenged in the same light.\(^75\)

Cornelissen\(^76\), commented on the court’s ruling in ITC 1830 and had the following to say:

‘In my view, the minority judgement in the Conshu case represents the accepted approach. The minority judgement in this case held that to ascribe a different meaning to the term ‘income’ than the definition in s 1 would result in the anomaly that, where a company incur a loss in years one and two, the loss in year one could not be carried forward to year three because a continuity of set-off is required. Sars acknowledged the problem with the practical implementation of an income from trade requirement and it is exactly for that reason Interpretation Note 33 was issued’

\(^75\)Dirk Kotze ‘Assessed losses and income from trade : SARS interpretation notes’(2009) 11 Tax Breaks Newsletter 5
\(^76\)C Cornelissen ‘The Gauteng Tax Court confirms the income from trade requirement’ (2008) 28 De Rebus 52
Kotze\textsuperscript{77}, lists concerns that came about after the judgement in ITC 1830 :-

- The first issue of concern in terms of the judgement is the practical impact in the case of companies that have commenced trading and incurred expenditure but have not yet generated trade income due to a time lag between commencement of trade and generating income.

- The second concern is SARS' apparent disregard for its own Interpretation Note in this instance.

- The third concern is the usefulness of documentation issued by SARS setting out their views and practices relating to tax law and used by tax experts in dealing with their clients.

The Interpretation Note even provides an example of farming company that plants trees that will bear fruit after four years and which earns no income in the first three years. Despite the fact that the company derived no income from trade during the first three tax years, SARS will permit the company to carry forward its assessed loss and set them off against the income derived in the fourth tax year. The reason for the failure to derive any income during the years in question clearly stems from the nature of the company's trade.

\textsuperscript{77}Dirk Kotze ‘Assessed losses and income from trade : SARS interpretation notes’(2009) 11 Tax Breaks Newsletter5
The disallowance of the assessed loss in this example would appear to be no different than a loss incurred in the development of a royalty-producing asset and a loss incurred in the development of an orchard from which to harvest a product.

It is concerning that SARS was not prepared to make concessions to the taxpayer in ITC 1830 on the same basis as set out in the Interpretation Note.

According to Wilson\textsuperscript{78},

‘Interpretation notes should act as a beacon to taxpayers, that provided their circumstances are consistent with those enumerated in the relevant interpretation note, they should expect to assessed on the basis set out. The problem is that these interpretations are not legally binding on SARS – as the courts concluded’

Unlike decisions of the High Court, decisions of the tax court do not create precedents and need not be followed by other tax courts. This decision is thus not binding in the true sense of the word in future decisions of the other courts or High Courts.

**4.4 CONCLUSION**

In terms of section 20(1), a company can carry an assessed loss forward to the following year, but only if it earns income in that year. Interpretation Note 33, states

\textsuperscript{78}Ian Wilson ‘PriceWaterHouse monthly newsletter
that SARS is of the view that section 20 contains a trade requirement and an income from trade requirement, both of which must be satisfied before an assessed loss may be carried forward. However, SARS was prepared to make concessions where it could be proved that a trade was carried on, even though no income was earned during the tax year.

However the judge in ITC 1830 ruled that there has to be trade and there has to be income from that trade in order to carry forward the assessed loss, which has now effectively nullified the purpose and application of Interpretation Note 33.

It is clear from the judgement that SARS does not have the authority to change the law by making concessions which are clearly contrary to the plain wording used by the legislature.

A decision of the Supreme Court of Appeal is now necessary for a departure from the literal meaning of the words. In other words the section needs to be amended to make it clear that an assessed loss may be carried forward, even if a trade has been carried on and no income has been derived from such trade.

CHAPTER 5
ASSESSED LOSSES IN AUSTRALIA

5.1 INTRODUCTION
In South Africa, an assessed loss will be forfeited if a company does not trade ('trade requirement – dealt with in chapter 3), or if it has not derived income from that trade ('income from trade requirement' –dealt with in chapter 4).

Much of our tax system has been based on overseas law, including Australia and because of the complex issues surrounding assessed losses, a review of the method adopted by Australia in dealing with the carry forward of assessed losses in respect of companies has been done.

This chapter provides an overview of the Australian method of dealing with the carry forward of assessed losses for companies.

5.2 CARRYING ON A BUSINESS
The Australia tax system does not make use of the term 'trade' but uses the term 'carrying on a business' to refer to trading.
A company will be considered to be carrying on a business in Australia if its business dealings are done with repetition and continuity. These dealings can be part of or together with another business and do not have to have a profit motive.

A once-off transaction of substance could also be said to be carrying on a business.

As far as an individual is concerned, sub-section 995-1(1) of the ITAA defines ‘business’ as it relates to individuals for tax purposes to include any profession, trade, employment, vocation or calling but does not include occupation as an employee. However, this definition simply states what activities may be included in a business but it does not provide any guidance for determining whether the nature, extent and manner of undertaking those activities amount to the carrying on of a business.

Repetition and regularity of the activities are important. However, if what the taxpayer is doing is more properly described as a pursuit of a hobby/creation or an addiction to a sport, then they will not be deemed to be carrying on a business, even though their operations may be fairly substantial.

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80 A company will be defined as 995-1(1) of the Income Tax Assessment Act 1997 to mean a body corporate or other unincorporated association or body corporate, excluding partnerships or non-entity joint ventures.
It must be noted that this treatise does not deal with the carry forward of losses in respect of persons other than companies and details relating to individuals is for comparison purposes only.

A tax loss is arrived at when the total deductions claimed for a tax year exceed the income for the year.

5.3 CARRYING FORWARD OF ASSESSED LOSSES

Individuals, both those in business (sole traders and partners) and those not in business, can generally carry forward a tax loss indefinitely, but must utilise a tax loss at the first opportunity. In other words, if the income in the current income year exceeds the current year’s deductions, it has to be offset against any loss that has been carried forward from previous years against the current year’s income. One may not choose to hold onto losses to offset them against future income if they can be offset against the current year’s income.

However, in certain circumstances, individuals may have to treat losses from non-business activities (such as investments) and business activities separately.
As mentioned previously, this treatise specifically deals with the carry forward of assessed losses of companies. It does not deal with the carry forward of losses in respect of persons other than companies.

Compared to individuals, operating losses in companies can be carried forward indefinitely to be offset against taxable income derived during the succeeding years. However losses may not be carried back to prior years.

In terms of the Tax Ruling TR 1999/9 of the Income Tax Assessment Act 1995 (ITAA), a company may not deduct a tax loss unless either of the following apply:

- More than 50% of the owners remain the same (continuity of ownership test) (COT) and exercise the same control throughout the period from the start of the loss year to the end of the income year.
- It carries on the same business throughout a specific period (same business test) (SBT).

The tests have to be applied in the above order as the outcome of the COT determines if and how the SBT is to be applied.

The following needs to be taken into account when carrying forward tax losses.

- Losses from earlier years must be claimed first.

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81 Section 165-12 of the Income Tax Assessment Act 1997
82 Section 165-15 of ITAA 1997
• Losses from earlier years can be used to reduce income to zero only.
• Most losses can be carried forward indefinitely.

Furthermore, under certain conditions a taxpayer may be able to:
• Choose the amount of a previous year’s tax loss it wants to claim.
• Carry forward to a later year, a tax loss that a taxpayer would have earned in a particular year had it not received income from franked dividends\(^{83}\).

If a business is operated through a company, any losses incurred may not be distributed to the shareholders. Instead the loss may be carried forward and offset against taxable income in a later year.

5.4 CONTINUITY OF OWNERSHIP AND CONTROL TEST (COT)\(^{84}\)

The COT requires more than 50% of the voting, dividends and capital rights to be beneficially owned (directly or indirectly) by the same persons at all times during the ownership test period\(^{85}\).

The same shares need to be held in the same way in order for the shares to be counted as continuous holdings.

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\(^{83}\) A franked dividends are payments made to shareholders on which the company has already paid tax. These payments carry franking credits.

\(^{84}\) Section 165-12 of ITAA 1997

\(^{85}\) Division 165 of the ITAA 1997
Legislation also contains a ‘control test’ that requires that there be no change in control of the voting power of the company in order to obtain some tax benefit.\textsuperscript{86}

The ownership test period covers a period from the start of the loss year until the end of the income year in which a deduction is sought for the loss. The COT must be satisfied throughout the ownership period.

Where none of the shareholders are companies or trustees of trusts, the primary tests for continuity are that the same shareholders must, at all times during the ownership test period have the following rights:-

- To exercise more that 50% of the voting rights; and
- To receive more that 50% of any dividend or right to a dividend, and
- To receive more that 50% of any distribution of capital of the company.

According to the Australian Tax Office (ATO), if a company has incurred losses in more that one year, the losses are utilised on a first in, first out basis. That is, the earliest loss is tested first and, if it is not deductible, or if there is still income remaining after it is deducted, the next loss incurred is tested to see if it can be utilised.

\textsuperscript{86}Section 165-15 of ITAA 1997
5.5 SAME BUSINESS TEST (SBT)\textsuperscript{87}

If a company fails the COT or Control test, it may still be able to deduct prior year’s losses if it passes the SBT. SBT only applies if there is a failure of COT.

The requirements of the SBT will be fulfilled if all the following conditions are met throughout the prospective loss recoupment year :-

- The same business is carried on during the income year in which the loss is claimed and immediately before the change of ownership.
- The same business, does not necessarily mean, identical activities in all respects.
- The business can expand or contract, provided it retains its identity.
- The company does not derive income from a business or transaction of a new kind that it did not carry on before the test time\textsuperscript{88}.

The SBT is not available if the company’s gross income for the year is more than $100 million AUD.

Tax writers at PKF\textsuperscript{89}, state that where there are changes in a company’s business as well as its ownership, the dates on which the changes occur may be critical.

\textsuperscript{87} Section 165-12 ITAA 1997
\textsuperscript{88} Test Time is when a company fails the COT for a particular loss period
\textsuperscript{89} PKF ‘June Monthly newsletter’ (2007)
Ma\textsuperscript{90}, in her paper set out a model for applying section 165-210 of ITAA 1995, as detailed below:

**Step 1**
Identify all activities carried on, before the ‘test time’
(a) the same business test (SBT) is failed upon cessation of all activities before the test time.
(b) the anti-avoidance test is failed upon the addition of new activities to existing activities for tax-avoidance purposes.

**Step 2**
Identify all activities carried on in the recoupment year (i.e. the year in which the losses are offset by taxable income)

**Step 3**
Compare 1 and 2 to establish if the identity of the overall business is maintained?
(1) (a) If there are new activities in 2, is there assessable income or deductible expenditure?.
(b) Are these activities of a kind in 1? If no there is a failure of either the new business or new transaction tests

(2) Are the activities in 1 retained?

\textsuperscript{90} W Ma ‘The Continuity of Business Tests for Carrying Forward Losses’ (1998) 171 Revenue Law Journal
(a) If yes, identify the type and extent of changes
(b) If no identify the type and number of discarded activities.

Ma\textsuperscript{91} goes on to say that a good method to preserve carry-forward losses under the same business test would be to ring fence the losses in an entity and undertake new business in a separate entity that satisfied the requirement of the same ownership test.

5.6 TRANSFER OF LOSSES

Division 150-A of the ITAA allows wholly-owned groups of companies to transfer losses to each other. Under consolidation, all companies will be treated as one company, for the purpose of determining the tax liability.

Each company is an independent entity for tax purposes and needs to account for its tax position separately. In some cases, certain companies may have a tax liability and the other a tax loss which can be carried forward.

The companies must meet the requirements of the group membership at all times from the beginning to the end of the tax year. The amount of the tax loss that can be transferred between the wholly-owned companies is limited to the taxable income of the transfer company.

\textsuperscript{91} W Ma, ‘The Continuity of Business Tests for Carrying Forward Losses’ (1998) 175 Revenue Law Journal
Kathari\textsuperscript{92}, contends that:

“Generally losses can be transferred to the groups, only if the losses could have been used outside the groups by the entity seeking to transfer said loss. Once a subsidiary member of a group transfers a loss, it is no longer available for use by the subsidiary, even if the subsidiary subsequently leaves the group”.

5.7 ATO CRACKDOWN ON TAX LOSSES OF SMALL TO MEDIUM ENTERPRISES

Business in the small to medium enterprises (SME) sector have reported high losses created by the impact of the global financial crisis. Businesses have experienced changes to the structure and operations of the business. These changes are often needed to help the business meet the crisis.

The ATO has been on a national campaign to audit small to medium companies that have carried forward their assessed losses.

Some of the common mistakes identified are:

- Losses used where the company does not satisfy either the ‘continuity of ownership’ or ‘same business’ test
- Losses incorrectly transferred to the holding company
- No proper records kept to support the losses carried forward

\textsuperscript{92}Navneet Kothari.’ Worldwide Tax Trends Treatment of Tax Losses. ‘(2011)
- Losses do not satisfy the ‘same business’ test and results in further losses carried forward.
- Carried forward losses not being checked to ensure that they are correctly calculated.

Azzopardi\textsuperscript{93} states that taxpayers should get their paper work in order and ensure that all calculations can be properly supported, in the event they are faced with a review.

5.8 CURRENT YEAR LOSSES

Where the ownership of a company changes by more than 50% during the tax year, there are rules that require a company to calculate its taxable income for the year in a particular way.

The tax year will be split into periods and a notional taxable income or loss has to be calculated for each period. If there is a notional loss in the period before the change of ownership it cannot be included in the actual taxable income for the year unless the company passes in the same business test, in a similar manner describe above for the previous years losses.

\textsuperscript{93}M Azzopardi ‘ATO to attack use of loss’ (2010) Grant Thornton Tax Alert
Thus, a company in this situation will have both a taxable income and a tax loss for the same year. The loss may be carried forward and utilised in later years, subject to the normal restrictions imposed.

The steps to be carried out to calculate the loss under the 'loss rules' are as follows:

- divide the income year into periods bound by the time of each change in ownership or control,
- calculate the notional loss or income for each period,
- calculate the taxable income and tax loss for the tax year,
- carry forward any tax loss for the year.

5.9 CONCLUSION

From the above, it is evident that the treatment of assessed losses in Australia is complex, but it provides more certainty and is more equitable.

The operating losses can be carried forward indefinitely to be offset against taxable income derived during the succeeding years but the company needs to meet the greater of 50% continuity of ownership test. Where the continuity test fails, losses can be deducted if the same business is carried on in the income year (the same business test).
However one must adhere to the rules to carry forward previous years’ losses.

The next and final chapter details the conclusions drawn from the research and recommendations made.
CHAPTER 6

CONCLUSION AND RECOMMENDATIONS

The issues regarding the carry forward of assessed losses in terms of s 20(1) are complex. In terms of the section, a taxpayer company is only entitled to set off its assessed loss from the previous year against its taxable income in the current year, if the taxpayer has carried on a trade during the current year and has derived income from that trade during that year.

The section allows persons other than companies to carry forward their loss even if they did not derive any income from their trade.

The aim of this treatise was twofold. Firstly it was to gain clarity on the ‘trade’ and ‘income from trade’ issues and secondly it was to compare South African legislation with that of Australia, with a view to recommending a change in our rules regarding the treatment of assessed losses, in the context of companies.

The definition of ‘trade’ has been defined in s1 of the Act, and as pointed out by Silke, the definition is wide, but despite its wide meaning, the definition does not embrace all the activities of a taxpayer that might be productive of income.
From the research and as stated by Silke⁹⁴, the critical lessons to be learned from the cases relating to assessed losses is that the liquidators, creditors and others must be careful to continue trading in order to keep the assessed losses alive. The realisation of assets (including stock) during the liquidation does not constitute the carrying on of a trade. Also the collection of outstanding debts to be made available as capital earned before being placed into liquidation, and before disposing of it to third parties, also does not constitute the carrying on of a trade in terms of s 20(1)

Furthermore, according to Coetzee⁹⁵, the continuity of trade is an important element with regard to the carry forward of assessed losses. As was held in New Urban Properties, there has to be continuity in the setting-off of an assessed loss in every year after the year in which it was originally incurred.

In the case of SA Bazaars, the court held that if a company trades at any time during the year, it did not have to fulfil this requirement, and it did not have to trade continuously throughout the year. The court left open the issue whether it was necessary to derive income from that trade.

⁹⁵ H Coetzee ‘Some aspects of assessed losses taxation (1998) 29 Accountancy SA 37
In ITC 664 (a case heard before SA Bazaars), the court held that there had to be income from trade. Then in ITC 777 (decided after SA Bazaars), the court took a different view. It held that even though a company tried to let property without success, it was allowed to carry forward an assessed loss.

According to Temkin, it is normally difficult to determine whether a company has carried on a trade and that SARS has stated in Interpretation Note 33 that it will apply an objective test to determine that a trade has in fact been carried on, but the Note did not describe how SARS will carry out that test.

Thus, if a company wishes to preserve its assessed loss, it should ensure that it carries on some activity that falls within the definition of trade.

Interpretation Note 33 issued by SARS was supposed to be a guideline to help taxpayers understand the rules surrounding assessed losses and even gave taxpayers a concession in certain cases. Then in ITC 1830, the court ruled that a company must trade and must derive income from that trade in order to carry forward its assessed loss, which has now nullified the application of Interpretation Note 33.

It is apparent that SARS did not have the authority in the first place to make concessions, which was clearly contrary to the wording of the Act.
In comparing these issues to that of Australia, it is clear the Australia has a complex method for dealing with the carry forward of assessed losses, but it provides more certainty and is more equitable.

It allows operating losses to be carried forward indefinitely to be offset against future income. However, in order to recover prior years' losses, a company must meet the more than 50% continuity of ownership test. Where the continuity test fails, losses can be deducted if the same business is carried on in the income year (the same business test).

In order to solve the issues surrounding the carry forward of assessed losses it is suggested that either one of the following be adopted:

- Adopt the method used in Australia for the carry forward of assessed losses. However, note that if this route is adopted, careful planning needs to take place., or
- A decision by the Supreme Court of Appeal is required for a departure from the literal meaning of the words pertaining to the requirements regarding assessed losses or a legislative change needs to be made. Furthermore, to clarify the definition of ‘income’, is it gross income less exempt income or taxable income? If section 20 relates to taxable income, then an assessed loss will never be increased, which it is submitted, is not what the legislature intended.
Section 20 ought therefore to be revisited to eliminate any uncertainty about the income requirement and in the context in which the word ‘income’ is used in that section.

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