

SOUTH AFRICA / JUDGMENT

Commissioner For Inland Revenue v Standard Bank of South Africa Ltd. (81/85) [1985] ZASCA 63; [1985] 2 All SA 512 (A) (22 August 1985)

[1985] ZASCA 63

COURT

Supreme Court of Appeal

BEFORE

Corbett, Miller, Van Heerden, Hefer, Galgut

CASE / FILE NUMBER

81/85

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IN THE SUPREME COURT OF SOUTH AFRICA (APPELLATE DIVISION.)

In the appeal of

COMMISSIONER FOR INLAND REVENUE appellant and STANDARD BANK OF SOUTH AFRICA LIMITED respondent

Coram: CORBETT, MILLER, VAN HEERDEN, HEFER, JJA, ot: GALGUT AJA.

Date heard: 15 May 1985

Date of Judgment: 22 August 1985

J U D G M E N T

CORBETT JA :

This is an appeal from the Transvaal Income Tax Special Court, leave to appeal direct to this Court having

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been given by the President of the Special Court in terms-of sec. 86A(5) of the Income Tax Act 58 of 1962, as amended ("the Act").

Respondent is the Standard Bank of South Africa Ltd ("the Bank"), a registered commercial bank operating throughout the Republic of South Africa and having its head office in Johannesburg. In its income tax returns for the years of assessment ended 31 December 1979, 31 December 1980 and 31 December 1981 the Bank claimed as deductions from its income the Co II owing amounts respectively. In relation to these three years of assessment, viz. R127 018 683, R117 275 018 and

R299 409 076, as representing interest paid by it on moneys borrowed. In terms of additional assessments for the 1979 and 1980 tax years and an original assessment for the 1981 tax year (all of these assessments having been issued in about May 1982) the Commissioner for Inland Revenue ("the Commissioner") dis-

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3allowed portion of each of these deductions, the amounts disallowed being respectively R1 820 373, R1 937 572 and R6 010 992, and taxed the Bank accordingly. Its objection to the disallowance of these amounts having been overruled by the Commissioner, the Bank appealed to the Special Court, which upheld the appeal, set aside the assessments and referred the matter back to the Commissioner for re-assessment in terms of its

judgment.

The Commissioner, as appellant, now seeks in this Court the reversal of the decision of the Special Court.

In a nutshell, the dispute between the parties concerns the utilization by the Bank, in the years of assessment under consideration, of a portion of the deposit moneys available to it for investment in the purchase of redeemable preference shares. Since the amounts received by the Bank by way of dividends on these shares are not taxable in the hands of the Bank (by virtue of sec. 10(1)(k) of the Act), the Commissioner contends that a proportionate amount of the interest paid to depositors on the deposit moneys, being

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non-productive of "income" (as defined in the Act), should be disallowed as a deduction in the computation of the

Bank's taxable income. The Bank disputes the validity of this contention.

Before I discuss the legal issues involved in this dispute, I must make some reference to the facts. These appear from the dossier of documents and the evidence of Dr C B Strauss, the managing director of the Bank and the only witness called in the Court a quo. If one is to judge by the cross-examination of Dr Strauss by the Commissioner's representative in the Special Court, it would seem that what he stated in evidence is not in dispute.

At the outset, I should explain that the Bank is a wholly-owned subsidiary of Standard Bank Investment Corporation ("SBIC"), a company quoted on the Johannesburg Stock Exchange, and that the assets of the Bank represent about 70 per cent of the assets of SBIC. In addition, other subsidiary companies, such as Standard Merchant Bank

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Standard Bank Credit Corporation and Standard Bank Industrial Finance Corporation, go to make up a Standard Bank Group. Various banking operations are conducted by different members of the Group, but, for the sake of simplicity, in my

discussion of the facts I will refer merely to the Bank.

Judged by total assets held, the Bank is the second largest commercial bank in the country.

What the evidence of Dr Strauss reveals is that basically and in simple terms the business of the Bank (and of other commercial banks like respondent) consists of borrowing moneys by way of customers' deposits, upon which it pays interest to the customer, and of lending out these moneys in various ways and thereby earning income (in the ordinary, non-technical sense of the word) in the form of interest and other forms of compensation paid by the borrower to the Bank for the use of the money. Naturally, the Bank so arranges its affairs that the general return it obtains on the moneys lent by it exceeds the interest

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which it has to pay to its customers/depositors. This excess represents, broadly speaking, the gross profit of the Bank.

What Dr Strauss referred to as the "primary function" of the Bank of collecting deposits may be divided into two categories, retail deposit-gathering and wholesale deposit-gathering. The former function is carried on throughout the country through the net-work of more than a thousand branches of the Bank. Funds are gathered through the deposit of moneys by customers in hundreds of thousands of current, savings and fixed deposit accounts maintained with these various branches of the Bank. The wholesale deposit-gathering function is handled largely by the investment division of SBIC on behalf of the Bank. This relates to deposits in excess of R100 000, usually made by institutions such as pension funds, insurance companies, mining houses and other banks, in the form of fixed deposits or what are termed negotiable certificates of deposit.

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The Bank accepts all deposits that are offered to it, provided that the customer agrees to the quoted interest rate. Indeed all branches are instructed to take as many deposits as they can. This is a matter of commercial necessity. In order to grant loans a bank must have money available. This money it acquires by taking deposits. Moreover, the Bank has a large and costly infrastructure and if this is not used effectively and to its full potential, then the cost of the Bank's

overheads becomes disproportionate to its earnings, and its commercial, efficiency diminishes. As Dr Strauss put it

".... it is simply not a practical business proposition for any bank, not necessarily this one, to refuse to take deposits at the rate that is acceptable".

Of the deposits that have been gathered by the Bank, certain proportions must, in terms of the Banks Act 23 of 1965, be devoted to the maintenance of the required minimum reserve balance with the Reserve Bank, of the minimum

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8liquid asset requirement and of the minimum prescribed investments requirement (see secs. 16, 17 and 18 of the Banks Act). The balance of the deposits, apart from what is utilized in the acquisition of fixed property, then goes into a common pool used for financing the borrowing needs of the Bank's customers. The Bank's main instrument of lending is the overdraft on current account, which represents the "vast bulk" of customer Financing. In addition, the Bank also finances acceptance credits, leases and suspensive sales, provides factoring facilities and grants medium-term loans. In recent years the taking up of redeemable preference shares has emerged as a requirement of customers in certain instances.

The redeemable preference share transaction is seen as. an alternative to the grant of a medium-term loan. Instead of the Bank advancing loan moneys to the customer, the Bank takes up redeemable preference shares issued to it by the customer, the term of redemption being equivalent to what would otherwise have been the period of the loan.

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9In fixing the dividend rate applicable to the shares, termed the "coupon rate", account is taken of the fact that the dividend is exempt from taxation in the hands of the Bank. This enables the Bank to offer a coupon rate substantially cheaper than the interest rate on an equivalent medium-term loan would have been. Therein lies the main advantage to the customer.

On the other hand, from the Bank's point of view the non-taxability of the dividend holds no particular advantage since the coupon rate is correspondingly lower than the interest rate on a medium-term loan (which interest is taxable) would be. Moreover, the security afforded by a preference share issue is inferior to that pertaining to a loan in that in the latter case the Bank has the status of a creditor and in the former is merely a shareholder. Nevertheless, though generally reluctant to do so, the Bank does participate (and in the tax years in question did participate) in a small

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number of redeemable preference share transactions at the customer's request. Generally the Bank is prepared to do so in order to accommodate special customers, with whom it has a long banker/customer association which might be prejudiced by a refusal, and also customers of high financial standing where there is the possibility of expanding the Bank's business with that customer. But the Bank never takes the initiative in offering a redeemable preference share transaction to a customer. Dr Strauss emphasized that other commercial banks followed the same practice of entering into redeemable preference share transactions and cited one instance in his experience where the Bank felt impelled to enter into such a transaction with an established customer because the customer had been offered a preference share loan" by another bank.

Dr Strauss maintained that these redeemable preference share transactions were "purely incidental

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to the main business of the Bank. To illustrate "the relative total insignificance of this investment or its incidental nature to the total operation of the Bank", Dr Strauss referred to certain schedules prepared by the Bank. These show:-

(a) That in the years 1974 to 1983 inclusive 34 such

transactions took place, an average of 3,4 per year. In 1975 there were no such transactions, while in 1980 there were six and in 1981 twelve. Dr Strauss ascribed the greater-than-average number of transactions in 1980 and 1981 to the very rapid expansion in the economy of the country which took place at that time. In 1982 and 1983 the figures were three and two respectively. The amounts invested in each such transaction varied over the years between R170 000 and R30m.

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(b) That during the three tax years in question the

ratio of the dividend income of the Bank attributable to the holding of redeemable preference shares to total funds income was as follows:

1979 1980 1981

1,98% 1,81% 2,55%

(c) That during these three tax years the ratio of the

asset value of the redeemable preference shares held

to the total assets and guarantees of the Bank was

as follows:

1,04% 1,39% 1,51%

As I have explained, in order to maintain profitability the Bank has generally to exact a higher rate of interest or return on the moneys which it lends than the rate of interest which it pays depositors. The margin between lending rates and borrowing rates had thus to be

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constantly monitored and, having regard to the general economic conditions and the market situation, adjustments have to be made by the Bank from time to time. In the case of redeemable preference shares, the coupon rate is determined with reference to the prime Lending rate and is fixed by an agreement (with the customer), which may provide for the rate to fluctuate. A schedule of redeemable preference share transactions prepared and put in by the Bank indicates considerable variation in the coupon rate and shows that in most instances the rate is a fluctuating one.

Dr Strauss was asked in examination-in-chief whether there was any connection between the acceptance of deposits or the rates at which the Bank would accept deposits, on the one hand, and the making of these investments in redeemable preference shares on the other. His reply was emphatic:

"I can say categorically, no. The Bank was in no way whatsoever influenced in setting deposit rates or in taking deposits by these particular assets, which, in my view, are purely incidental to the main business of the Bank - on the assets side of the balance sheet."

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No cross-examination was directed at this evidence.

In delivering the unanimous judgment of the Court a quo the President (MELAMET J) indicated the Court's acceptance of the evidence of Dr Strauss, which was "not disputed"; referred extensively to the decision of this Court in the case of Commissioner for Inland Revenue v Allied Building Society, 1963 (4) SA 1 (A); and held that the facts of the present case were "principally" indistinguishable from those in the Allied Building Society case and that, accordingly, the present case was governed by the principles laid down and applied therein. This led, as in the Allied Building Society case, to the success of the taxpayer's appeal.

On appeal, counsel for the Commissioner did not in any way challenge the correctness of the decision in the Allied Building Society case, but contended in general that the facts in that case were "clearly distinguishable" from those in the present case. Counsel for the Bank, on the

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other hand, relied heavily on the Allied Building Society case. It is, therefore, necessary to consider that decision in some detail.

The facts were very similar to those in the present case. The taxpayer was a registered permanent building society. It raised funds from the public by the issue of various types of shares, upon which it paid dividends, and the acceptance of saving and fixed deposits, upon which it paid interest. As a matter of commercial necessity the Society, like Che Wank in this case, accepted all moneys offered to it in respect of shares, on savings account or on fixed deposit. With these borrowed moneys the Society granted loans upon the security of the mortgage of urban property and made advances against the security of deposits made with, or shares held in, the Society. All moneys received by the Society were regarded as forming a single pool which was utilised generally for making all payments due by the Society, including, inter alia, interest due to depositors, dividends due to shareholders,

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management expenditure, expenditure (including capital expenditure) on properties and buildings owned by the Society, and payments made by the Society in the ordinary course of its business. It was not possible to link any cash receipt with any particular outgoing. Amongst the immovable properties held by the Society during the tax year in question were certain properties which were either temporarily unproductive, eg. buildings under alteration or reconstruction, or non-revenue producing, such as vacant stands. In determining the Society's liability for income tax in that tax year, the Commissioner disallowed as a deduction portion of the total sum paid out by the Society in dividends and interest on moneys borrowed by it. The amount deducted was calculated in accordance with a formula based upon the ratio of the value of the non-revenue producing assets of the Society to the value of its total assets. The Commissioner's contention was that is proportion of the Society's expenditure

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in the form of dividends and interest must be regarded as having been incurred in respect of borrowed moneys employed in the acquisition of capital assets not utilized by the Society in its income earning operations or in the course of its trade; and that, therefore, such expenditure was not deductible in terms of sec. 11(2)(a) of the Act and was prohibited from deduction in terms of sec. 12(g).

The Society's objection to this form of assessment was upheld on appeal to the Special Court. On appeal to this Court by the Commissioner, the Court (per OGILVIE THOMPSON JA, BEYERS JA and HOLMES JA concurring and STEYN CJ dissenting) upheld the decision of the Special Court and dismissed the appeal. Before considering the rationale of the majority judgment delivered by OGILVIE THOMPSON JA it is necessary to put the problem into its proper statutory perspective.

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The Allied Building Society case was decided in relation to the Income Tax Act of 1941, whereas in the present case the relevant legislation is the Act, but the statutory provisions under consideration are to all intents and purposes the same in each of these Acts. Firstly, there is the general deduction formula which permits the deduction from the taxpayer's income of -

"expenditure and losses actually incurred

in the production of the income,

provided such expenditure and losses are not of a capital nature."

(Sec. 11(2)(a) of the 1941 Act and sec. 11(a) of the Act.)

Then there are the so-called "negative counterparts" of the general deduction formula, viz. sec. 12(f) and (g) of the 1941 Act and sec. 23(f) and (g) of the Act, which prohibit a deduction in respect of (I quote the wording of the latter subsections) -

(f) any expenses incurred in respect

of any amounts received or accrued which do not constitute income as defined in section one;

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(g) any moneys claimed as a deduction

from income derived from trade, which are not wholly or exclusively laid out or expended for the purposes of trade".

In regard to the general deduction formula, it is settled law that generally in order to determine in a particular case whether moneys outlaid by the taxpayer constitute "expenditure incurred in the production of the income" important, sometimes overriding, factors are the purpose of the expenditure and what the expenditure actually effects. And in this connection the Court has to assess the closeness of the connection between the expenditure and the income-earning operations (see *C1R v Nemojim* 1983 (4) SA 935 (A), at p 947 G-H and the authorities there cited).

As to the negative counterparts to the general deduction formula, subsection

(g) does not in this case evoke particular comment. Subsection

(f) is more pertinent in that its purpose is to exclude from deduction expenses

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incurred by a taxpayer in respect of such parts or forms of "gross income" as fall within the exemptions of sec. 10 of the Act, including sec. 10(1)(k) which relates to dividends received by or accruing to a company (see *CIR v Nemojim*, supra, at 947 U - C). Here too, when considering whether moneys outlaid by the taxpayer constitute expenses incurred in respect of amounts received or accrued which do not constitute income, ie constitute "exempt income", the court must assess the closeness of the connection between the expenses incurred and the exempt income received or accrued, having regard to the purpose of the expenses and what the expending thereof actually effects (*CIR v Nemojim*, supra, at p 947 H - 948 A).

I return now to the majority judgment in the *Allied Building Society* case. In support of the Commissioner's general contention in that case his counsel argued in this Court that the true criterion of deductibility was not the

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purpose for which the Society borrowed but the actual use to which the borrowed money was put: the Society's business consisted of

(a) revenue producing operations and (b) the acquisition of capital assets and the cost of borrowing money for (b) was not deductible expenditure.

Although no non-revenue producing properties were acquired by the Society during the tax year in question and although the Society's reserves exceeded the value of all its immovable properties, it was assumed, for reasons which need not be detailed, that part of the interest, etc. paid by the Society in that year related to borrowed moneys utilized in the acquisition of non-revenue producing properties.

With reference to counsel's argument (stated above) OGILVIE THOMPSON JA said (at p 1.3 C-H):

"In my view, the ultimate use or destination of all the money borrowed is not

- as is implicit in the Commissioner's contention - on the facts of the present case to be

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elevated into a decisive factor in determining the deductibility or otherwise of the interest payable on that money. In determining the purpose of the borrowing, the ultimate user of the money may, no doubt, in certain cases be a relevant factor; but the dominant question remains: what was the true nature of the transaction? In the particular circumstances of the present case, the most important factor in that enquiry is, in my opinion, the purpose of the borrowing.

The Society's purpose in borrowing money, upon which it pays the interest in issue, is manifestly to obtain the means of earning income. The Society's basic business is borrowing money cheaply and lending it more dearly. The money it borrows constitutes its floating capital which it lends out at interest, thereby earning income; the interest the Society pays on the money so borrowed is *prima facie* clearly an expenditure incurred in the production of income."

The learned Judge of Appeal then went on to emphasize the "crucial facts" that not only was it absolutely and vitally indispensable to the Society's business to borrow money, but that it was commercially necessary for the Society to accept, i.e. borrow, all money tendered to it by the public.

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The payment of interest was thus a payment necessarily made in order to earn income and the pre-requisites of deductibility set out in secs. 11(2)(a) and 12(g) were satisfied (see p 14 A-C).

OGILVIE THOMPSON JA continued (at p 14 D - 15 A) :-

"It is not, in my opinion, material whether all the money borrowed is in fact lent out again by the Society. For the Court is not concerned with whether a particular item of expenditure produced any part of the income, but with whether that item of expenditure was incurred for the purpose of earning income. (See *Rand Speculation and Finance Co. Ltd. v. Commissioner for Inland Revenue*, 1953 (1) S.A. 348 (A.D.)) Nor, in my view, does the existence of the common pool aid the Commissioner, as claimed by counsel for the appellant. For, bearing in mind that, in the sense explained above, unlimited borrowing is vital to the Society's income earning operations, it is not, in my opinion, imperative for the Society, in order to entitle it to deduct the full interest paid by it, to keep the borrowed money in a separate account directly available, as it were, for immediate lending out again. Even on the assumption that, because of the existence "of the common pool or otherwise, the Society has not been able affirmatively to show that all the money upon which it paid

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interest during the 1959 tax year was in fact actually used in its income earning operations, that circumstance would not, in my judgment, preclude the deductibility of all the interest paid by the Society. For it is, I think, abundantly clear that the Society's business is not the acquisition of immovable property - revenue producing or otherwise - but the earning of income by investment. The contention that the Society's business consists of both revenue producing operations and

the acquisition of capital assets, is, in my view, not borne out by the facts. The acquisition by the Society of such non-revenue producing properties as it holds is purely incidental to the business of borrowing money in order to earn income by investment. The holding or not holding of unproductive properties has never played any part in controlling the Society's policy in regard to the receipt of moneys from the public. The only controlling factor is what the public offers to the Society on loan. If the Society chose to let some of the borrowed money lie idle, that would afford the Commissioner no sufficient ground for reducing the sum deductible by the Society in respect of interest paid by it on the borrowed monies. *Financier v Commissioner of Taxes*, 1950 (3) S.A. 293 (S.R.), relied upon by counsel for the Commissioner, does not assist him. The principles enunciated by TREDGOLD, J., at p. 295 of the *Financier* case are in accord with the views I have endeavoured to express:

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In the present case there is, in my opinion, no sufficiently close association between the borrowing and the non-revenue producing properties as to warrant the view that portion of the interest paid by the Society on the money it has borrowed is expenditure of a capital nature, or the view that such interest is not wholly or exclusively expended by the Society for the purposes of trade. In my judgment, the correct view of the facts of the present case is that the Society's expenditure by way of interest on moneys borrowed by it is not aimed at augmenting its fixed capital in general or its non-revenue producing properties in particular, but is dictated by the very nature of its income earning operations of cheaply borrowing all money offered and then more dearly lending out as much thereof as, subject only to the dictates of business prudence, it can possibly invest."

In *Financier v Commissioner of Taxes*, 1950 (3) SA

293 (SR) the principles enunciated by TREDGOLD J at p 295 C - D and approved of by OGILVIE THOMPSON JA were the following:

"1. Where a taxpayer borrows a specific sum of money and applies that sum to a purpose unproductive of income, and not directly connected with the income-earning part of his business, then the interest paid on the borrowed money cannot be deducted as expenditure incurred in the production of income.

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2. Where a taxpayer has for good and sufficient reasons borrowed money for use in the business producing his income, despite the fact that he subsequently, in pursuit of a legitimate business purpose, invested such money in an investment which does not produce taxable income, the interest is still deductible for income tax purposes.

It would seem that the test to be

applied is the purpose for which the money was borrowed."

Finally, I would refer to the case of CIR v Genn and Co (Pty) Ltd 1955

- (3) SA 293 (A), in which it was expressly held that interest paid on money borrowed and used as floating capital in the business of the taxpayer constitutes deductible expenditure in terms of the general deduction formula.

The foregoing cases establish, I would venture to suggest, the following:-

- (1) Generally, in deciding whether monies outlaid by a taxpayer constitute expenditure incurred in the production of the income (in terms of the general deduction formula) important and sometimes overriding

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factors are the purpose of the expenditure and what the expenditure actually effects; and in this regard the closeness of the connection between the expenditure and the income-earning operations must be assessed. The same general test applies to the provisions of sec. 23 (f) of the Act.

- (2) More specifically, in determining whether interest

(or other like expenditure) incurred by a taxpayer in respect of moneys borrowed for use in his business is deductible in terms of the general deduction formula and its negative counterparts in the Act, a distinction may in certain instances have to be drawn between the case where the taxpayer borrows a specific sum of money and applies it to an identifiable purpose, and the case where, as in the instance of the Society in the Allied Building Society case and the Hank in the present case, the taxpayer borrows money generally and upon a large scale in order to raise floating capital for use in his (or its) business.

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- (3) In the former type of case both the purpose of the expenditure (in the form of interest) and what it actually effects can readily be determined and identified: a clear and close causal connection can be traced. Both these factors are, therefore, important considerations in determining the deductibility of the expenditure.

- (4) In the latter type of case, however, and more particularly in the case of institutions Like the Society and the Bank, there are certain factors which prevent the identification of such a causal connection and one cannot say that the expenditure was incurred in order to achieve a particular effect. All that one can say is that in a general sense the expenditure is incurred in order to provide the institution with the capital with which to run its business; but it is not possible to link particular expenditure with the various ways in which the capital is in turn

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29 utilized. (It was, I deduce, with this in mind that in the Allied Building Society case OGILVIE THOMPSON JA held that the ultimate use or destination of the money borrowed by the Society was not on the facts of that case to be elevated into a decisive factor in determining the deductibility of the interest payable on that money; but that the most important factor was the purpose of the borrowing.)

- (5) The factors I refer to are these:

- (a) As a matter of commercial necessity the institution accepts, ie borrows, all moneys tendered to it by depositors. (b) All moneys borrowed go into a common pool which constitutes a general fund used for all purposes. (c) Generally the institution's expenditure by way of interest on borrowed moneys is not aimed at any particular form of utilization of the borrowed moneys: it is rather- dictated by the very nature of the institution's income-earning opera-

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tions of cheaply borrowing all money offered and then dearly lending out as much thereof as it can possibly invest.

As in the Allied Building Society case, therefore, it seems to me that the vital enquiry in the present matter is the Bank's purpose in borrowing the moneys upon which it paid interest to depositors (cf. Judgment at p 13 C) ; and in regard thereto it must be asked whether the connection between the expenditure of the interest (or some of it) and the acquisition of the redeemable preference shares was sufficiently close to Justify the conclusion that such expenditure was in each year of assessment incurred in the production of the dividends derived from the shares or was an expense incurred in respect of exempt income. The immediate purpose of the Bank in borrowing the deposit moneys was to obtain the floating capital with which to run its business. That floating capital was utilized by the Bank in many different ways.

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These have been detailed. Some of this capital was, in each of the years under consideration, used to take up redeemable preference shares, which produced exempt income. Can it, however, be said that there was a connection between a certain proportion of the interest paid to depositors and the dividends received on these shares close enough to justify the conclusion that the payment of such interest was incurred in the production of exempt income (and therefore not deductible in terms of sec. 1.1 (a) since it was not incurred "in the production of income") or was an expense incurred in respect of an amount not constituting income (resulting in deductibility being prohibited by sec 23(f))?

In my opinion, these questions must be answered in the negative. There are a number of factors which lead to this conclusion. Firstly, as the evidence shows, the Bank accepts all deposits offered to it in accordance with its terms as a matter of business policy. Deposit-raising is not determined by the manner in which the capital raised

/is 32 is to be utilized. Secondly, as Dr Strauss pointed out so emphatically, there is no connection between the acceptance of deposits or the rates at which the Bank was prepared to accept deposits and the making of investments in redeemable preference shares. Thirdly, there is the unchallenged evidence that the Bank is generally reluctant to participate in preference share transactions; it does so only in a few exceptional instances, for good business reasons, at the request of particular customers; it never takes the initiative in offering a preference share transaction. fourthly, preference share transactions generally constitute a small and insignificant part of the Bank's total lending business and were described by Dr Strauss (again without being challenged thereon) as being "purely incidental to the main business of the Bank". The figures substantiate this assertion. In view of the Bank's reluctance to enter into such transactions, it would be a matter of uncertainty every year how many preference share acquisitions, if any, the

/ Bank

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Bank would make. Thus, for example, in 1975 there were none and in 1977 only one was made two weeks before the end of the financial year.

Counsel for the Commissioner argued that the Allied Building Society case was distinguishable from the present case on the facts, in that "the purchase of redeemable preference shares is part of the Bank's business whereas the acquisition of the properties by the Society was merely incidental to its business". (1 quote from counsel's heads of argument.) It is true that in the present case the preference share transactions form part of the Bank's money-lending, operation, whereas this was not the case with the Society's property acquisitions, but, in my view, this does not prevent each of these activities being regarded as incidental to the main business of the Bank or the Society, as the case may be. If "incidental" in this

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context means "occurring or liable to occur in fortuitous or subordinate conjunction with something else" (see Shorter Oxford Dictionary sv "incidental"), then for the reasons which I have already elaborated it seems to me that the word aptly describes both the share transactions and the property acquisitions.

Counsel further submitted that the Court a quo

wrongly held that there was "no connection between the raising of the deposits and the taking up of the preference shares" by the Bank. The finding quoted sounds like an overstatement when thus taken out of its context, for in a sense there was some sort of connection. But the learned

President went on to say —

"The deposits were not raised for this purpose - the appellant accepted all deposits if the rate, was right. All money so raised went into the general pool."

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It is thus clear that the Court a quo was considering whether there was a close enough connection to link the purpose of the raising of the deposits with the taking up of the preference shares; and concluded that there was not. With this conclusion I agree.

Counsel argued that the finance committee of the Group, which determined interest rates, was aware that a known percentage of all deposits accepted by the Bank would have been used to acquire redeemable preference shares; and that this knowledge must have had an effect on the decision to raise or lower interest rates from time to time. This argument is without substance. Its factual premise is denied by the unchallenged evidence of Dr Strauss.

My conclusion is that the Court a quo correctly held that this case was governed by the principles laid down in the Allied Building Society case. And, in my view, there is no valid basis for treating portion of the interest

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paid by the Bank to depositors as not falling within the general deduction formula of sec. 11(a) or as being excluded from deduction by sec. 23(f).

The appeal is dismissed with costs, including the costs of two counsel.

M M CORBETT

Miller JA) Van Heerden JA) Hefer JA) CONCUR. Galgut AJA)

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