The Imputability of Sub-Income Under Section 7(3) of the Income Tax Act 1962

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Abstract

Section 7(3) of the *Income Tax Act* 58 of 1962 counters income splitting arrangements by imputing income received by a minor child *by reason of* a donation, settlement or other disposition made by the minor child's donor parent to such donor parent, thereby subjecting the imputed income to the donor parent's normal tax rate. The construction of the phrase *by reason of* has been a point of contention in cases dealing with sub-income (income on income). The secondary literature shows disagreement on whether it is still possible to successfully argue, as was done in the past, for an interpretation of *by reason of* that excludes sub-income from the scope of section 7(3). In addition to this disagreement, key judgments on the imputability of sub-income were delivered in 1949 and 1955, predating the enactment of section 39(2) of the *Constitution of the Republic of South Africa,* 1996 and the landmark judgment in *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 2 All SA 262 (SCA), which introduced significant shifts in the landscape of statutory interpretation. This study applies the *Endumeni* interpretative framework to section 7(3), with the discussion being structured around the modalities of the augmented Savignian Model. The analysis reveals that the present reliance on the Appellate Division's pre-1996 judgment in *CIR v Widan* is justified and therefore that sub-income may be imputed to a donor parent under section 7(3) if the parent's donation, settlement or other disposition is the effective (or proximate) cause thereof.

Keywords

Sub-income; proximate cause; efficient cause; income splitting; minor child; section 7(3).

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1 Introduction

Section 7(3) of the *Income Tax Act* 58 of 1962 (hereafter *1962 ITA*) is an anti-avoidance provision designed to counter income-splitting arrangements between parents and minor children. It does so by imputing income that has been received by, accrued to, expended for the maintenance of or accumulated for the benefit of a minor child to a donor parent if the income is *by reason of* any donation, settlement or other disposition (DSOD) made by the donor parent (own emphasis).

The proper interpretation of the phrase *by reason of* and specifically whether sub-income[1] could be imputed to a donor parent under the immediate predecessor of section 7(3), section 9(3) of the *Income Tax Act* 31 of 1941,[2] was considered in *Kohler v CIR*[3] and in *CIR v Widan*.[4] The problem with sub-income is best illustrated with an example. Suppose a parent donates a rent-producing property to her minor child and the minor child subsequently receives rental income. The rental income is reinvested in foreign equity shares which produce taxable foreign dividends. The question is whether the minor child received the sub-income (taxable foreign dividends) *by reason of* her parent's DSOD or in the alternative *by reason of* the reinvestment decision. In the case of the former, the sub-income (the taxable foreign dividend) can be imputed to the donor parent and in the case of the latter it cannot, so went the arguments before the courts in *Kohler* and in *Widan.*

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1 Alternatively, "income on income" - to be contrasted with income earned in the first instance, which is to be construed as income immediately produced by the capital donation (see *Kohler v CIR* 16 SATC 312).

2 Section 9(3) of the *Income Tax Act* 31 of 1941 (hereafter *1941 ITA)* provided: "Any income shall be deemed to have been received by the parent of any minor child, if by reason of any donation, settlement or other disposition made by that parent of that child - (a) it has been received by or accrued to or in favour of, or has been deemed to have been received by or accrued to or in favour of that child, or has been expended for the maintenance, education or benefit of that child; or (b) it has been accumulated for the benefit of that child." Unlike s 7(3) of the *Income Tax Act* 58 of 1962 (hereafter *1962 ITA*), s 9(3) of the *1941 ITA* does extend to stepchildren. Additionally, para (a) also includes income that "has been deemed to have been received by or accrued to or in favour of that child" - a formulation absent from s 7(3) of the *1962 ITA*. However, these differences are irrelevant to the purposes of this study. The key phrase in s 9(3) of the *1941 ITA*, "if by reason of any donation, settlement or other disposition made by that parent of that child," was directly carried over into s 7(3) of the *1962 ITA*.

3 *Kohler v CIR* 16 SATC 312 (hereafter *Kohler*), also cited as *Kohler v CIR* 1949 4 SA 1022 (T).

4 *CIR v Widan* 19 SATC 341 (hereafter *Widan*), also cited as *CIR v Widan* 1955 1 SA 226 (A).

In *Kohler* the Transvaal Provincial Division of the High Court reasoned that:

i. Section 9(3) required a strict construction – that some limit should be taken to have been imposed by the legislature on the taxability of the parent arising from a DSOD made for the benefit of a minor child.[5]

ii. The parent's DSOD was merely a *causa sine qua non* of the sub-income.[6] The reinvestment decision was effectively considered to be a *novus actus interveniens* that neutralised the causative potency of the parent's DSOD.[7] The reinvestment decision and not the DSOD was the proximate cause of the sub-income, with the result that the sub-income was received *by reason of* the reinvestment decision and not *by reason of* the parent's DSOD.

Finding in favour of the taxpayer, Murray J (with Grindley-Ferris A.J concurring) held that sub-income could not be imputed to a donor parent under section 9(3).[8]

Soon after the *Kohler* judgment, the Appellate Division (AD) had occasion to interpret the scope of section 9(3) in *Widan.* The AD questioned the correctness of the precedent established in *Kohler* even though the precedent had not been challenged before the Special Court, whose decision was the subject of the Appeal,[9] and despite the fact that the Commissioner had argued that the *ratio* of the *Kohler* case could be accepted without weakening his argument because the facts of the *Kohler* and *Widan* cases were distinguishable.[10]

In a unanimous decision the AD pronounced that:

(a) When interpreting a provision in a taxing statute, the intention of the legislature must be ascertained by analysing the language it used.[11]

(b) If the reasoning in *Kohler* was correct, then section 9(3) could be applied only in cases where a parent donates capital which is already

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5 *Kohler* 317. In the absence of such a limit and until the minor reaches the age of majority, a continuous chain of "income upon income" and "income upon income upon income" would arise and all these amounts would have to be regarded as arising not from any subsequent profitable use of the minor's capitalised income but from the parent's DSOD (see *Kohler* 318).

6 *Kohler* 318.

7 Refer to the argument advanced on behalf the taxpayer in *Kohler* 316. Also see *Widan* 350 where Centlivres CJ discusses the *Kohler* case and the true meaning of "proximate cause".

8 *Kohler* 318-319.

9 *Widan* 349.

10 *Widan* 343, 349.

11 *Widan* 351.

invested, and it was unlikely that the legislature intended that the words *by reason of* should have such a narrow application.[12]

(c) Proximate cause is not an absolute term but to construe it as the cause closest to the income in either space or time (as was done in *Kohler*) would be to misunderstand it. A cause that is truly proximate is one that is proximate in efficiency.[13]

(d) Every case must be decided on its own facts and if the effective cause of the income is the parent's DSOD, then the income is received *by reason of* the DSOD and can be imputed to the donor parent.[14]

The secondary literature shows disagreement as to whether the *Kohler* and *Widan* judgments are conflicting. Williams[15] states in no uncertain terms that the AD (in *Widan)* held that the decision in *Kohler* was wrong. In referring to the contrasting interpretations of the two cases, Davis J in *CSARS v Woulidge*[16] also opined that the AD (in *Widan)* rejected the approach that was adopted in *Kohler.* Emslie and Davis[17] propose that the AD (in *Widan*) did not expressly, but effectively overturned the precedent established in *Kohler* to the extent that its interpretation in *Widan* differed from that given in *Kohler*. McCarthy[18] agrees that the judgment by the AD in *Widan* must be regarded as taking precedence over the judgment in *Kohler*. The author of this article subscribes to the view that the AD (in *Widan)* rejected the construction of the phrase *by reason of* in the *Kohler* judgment.

On the other end of the spectrum of opinions, Haupt[19] proposes that the AD's decision in *Widan* "is not in conflict with *Kohler's* case as it was based on the peculiarities of the case". Ogutto[20] also takes the view that the facts of *Kohler* and *Widan* cases can be distinguished.

Aside from this disagreement, the issue concerning the imputability of sub-income is further complicated by the fact that the *Kohler* and *Widan* judgments were handed down in 1949 and 1955 respectively, predating the adoption of the *Constitution of the Republic of South Africa*, 1996 (the *Constitution*) on 27 April 1996. Devenish[21] argues that the lower courts should be bound by the *ratios* of higher courts in respect of "pre-

12 *Widan* 350.
13 *Widan* 350.
14 *Widan* 352.
15 Williams *Income Tax in South Africa* 171.
16 *CSARS v Woulidge* 62 SATC 1. Although the decision in *Woulidge* was later taken on appeal in *CSARS v Woulidge* 63 SATC 483, the appeal dealt only with the application of the *in duplum* rule.
17 Emslie and Davis *Income Tax Cases and Materials* 985.
18 McCarthy *Income Tax Practice Manual* A:D32 Donations - Minor Children.
19 Haupt *Notes on South African Income Tax* 799.
20 Ogutto *Curbing Offshore Tax Avoidance* 365.
21 Devenish 2007 *Obiter* 19.

constitutional" judgments only if those judgments are compatible with the purposive or value-based methodology that must now be applied to interpret legislation in conformity with section 39(2) of the *Constitution*. Similarly, Goldswain[22] argues that section 39(2) acts as a catalyst, providing taxpayers with a realistic opportunity to challenge long-standing precedents.

The imputability of sub-income under section 7(3) has not received judicial attention since section 39(2) of the *Constitution* prompted our courts to adopt the "purposive or value-based methodology" of statutory interpretation. This article aims to provide clarity as to whether sub-income is within the scope of section 7(3) by determining whether the "pre-constitutional interpretation" of the phrase *by reason of* aligns with contemporary interpretative principles.

2 Research method

The outcomes of the process of interpretation are related to the interpretational choices that interpreters make as a matter of method.[23] In 2012 the Supreme Court of Appeal delivered a landmark judgment in *Natal Joint Municipal Pension Fund v Endumeni Municipality*[24] that sought to definitively address the proper approach to interpreting legal documents in South African law. Paragraph 18 of *Endumeni* has since been quoted with unqualified approval by the Constitutional Court in *Airports Company South Africa v Big Five Duty Free (Pty) Ltd*.[25] In *CSARS v United Manganese of Kalahari (Pty) Ltd*,[26] the Supreme Court of Appeal also confirmed that the *Endumeni* approach applies equally to taxing statutes. The principles of the *Endumeni* approach to interpretation were articulated as follows:

> Whatever the nature of the document, consideration must be given to the language used in light of the ordinary rules of grammar and syntax; the context in which the provision appears; the apparent purpose to which it is directed and the material known to those responsible for its production. Where more than one meaning is possible each possibility must be weighed in the light of all these factors. The process is objective not subjective. A sensible meaning is to be preferred to one that leads to insensible or unbusinesslike results or undermines the apparent purpose of the document. Judges must be alert to, and guard against, the temptation to substitute what they regard as

22 Goldswain 2008 *Meditari* 119. Also see *Daniels v Campbell* 2004 7 BCLR 735 (CC) para 82.

23 Langbroek *et al* 2017 *Utrecht Law Review* 6.

24 *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 2 All SA 262 (SCA) (hereafter *Endumeni*).

25 *Airports Company South Africa v Big Five Duty Free (Pty) Ltd* 2019 2 BCLR 165 (CC) para 29. The principles espoused in *Endumeni* are now regarded as settled law in relation to the interpretation of documents (Seligson 2021 *Business Tax and Company Law Quarterly* 12; *Silverback Technologies CC v CSARS* 2023 4 All SA 629 (SCA) para 17).

26 *CSARS v United Manganese of Kalahari (Pty) Ltd* 2020 4 SA 428 (SCA) (hereafter *United Manganese*) para 8.

> reasonable, sensible or businesslike for the words actually used. To do so in regard to a statute or statutory instrument is to cross the divide between interpretation and legislation. In a contractual context it is to make a contract for the parties other than the one they in fact made. The 'inevitable point of departure is the language of the provision itself', read in context and having regard to the purpose of the provision, and the background to the preparation and production of the document.[27]

Section 39(2) of the *Constitution* guides statutory interpretation under the constitutional order.[28] The omission of an explicit reference to it in the much-cited paragraph 18 of *Endumeni* has therefore been noted with regret.[29] Section 39(2) of the *Constitution* provides that all statutes must be interpreted in a manner that promotes the spirit, purport and objects of the Bill of Rights; that is, through the prism of the Bill of Rights.[30] Fortunately the Supreme Court of Appeal later clarified *Endumeni's* methodological framework by explaining how context should be understood in relation to statutes, specifically emphasising that it includes section 39(2) of the *Constitution*.

> The difference in the genesis of statutes and contracts provides a different context for their interpretation. Statutes undoubtedly have a context that may be highly relevant to their interpretation. In the first instance there is the injunction in section 39(2) of the Constitution of the Republic of South Africa, 1996 ('the Constitution') that statutes should be interpreted in accordance with the spirit, purport and objects of the Bill of Rights. Second, there is the context provided by the entire enactment. Third, where legislation flows from a commission of enquiry, or the establishment of a specialised drafting committee, reference to their reports is permissible and may provide helpful context. Fourth, the legislative history may provide useful background in resolving interpretational uncertainty. Finally, the general factual background to the statute, such as the nature of its concerns, the social purpose to which it is directed and, in the case of statutes dealing with specific areas of public life or the economy, the nature of the areas to which the statute relates, provides the context for the legislation. It follows that context is as important in construing statutes as it is in construing contracts or other documents and the contrary suggestion is incorrect… .[31]

Endumeni does not explicitly classify its interpretative methods, but as argued below its core principles – text, context and purpose – naturally accommodate the reading strategies (or modes) that comprise the

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27 *Endumeni* para 18.

28 *Investigating Directorate: Serious Economic Offences v Hyundai Motor Distributors (Pty) Ltd: In re: Hyundai Motor Distributors (Pty) Ltd v Smit* 2000 10 BCLR 1079 (CC) (hereafter *Hyundai*) para 21.

29 See Le Roux 2019 *PELJ* fn 11; Bishop and Brickhill 2012 *SALJ* 715; the minority judgment in *Thistle Trust v CSARS* 2025 1 SA 70 (CC) para 97.

30 *Hyundai* para 21.

31 *United Manganese* para 17. Also see Wallis 2019 *PELJ* 14 where the spirit, purport and objects of the Bill of Rights are described as an essential part of the context in which legislation must be construed.

augmented Savignian Model, namely grammatical, systematic, teleological, historical and comparative interpretation.

Endumeni's directive to start with the language of the provision itself, applying ordinary rules of grammar and syntax,[32] amounts to grammatical interpretation. Grammatical interpretation is applied to unlock the "meaning potential" of a text. It derives the "initial" meaning of a provision through an analysis of its language and syntax.[33] *Endumeni's* directive to consider the context in which the provision appears[34] corresponds with systematic interpretation. Systematic interpretation is the contextualisation of a provision by interpreting it within the context of its related provisions and the statute as a whole.[35] *Endumeni's* directive to consider the context in which a provision appears and the apparent purpose to which it is directed[36] aligns with teleological interpretation, this being "a species of purposive interpretation"[37] in terms of which a provision is interpreted in the light of its purpose (*ratio legis)* and in a manner which conforms to the fundamental values of the legal system.[38] The *Endumeni* approach also emphasises context and specifically incorporates the consideration of "the material known to those responsible for its production" and "the background to the preparation and production of the document".[39] This aspect aligns with historical interpretation. Historical interpretation calls for the interpreter to be conscious of the provision's historical background.[40] It focusses on the genesis of the text.[41] Historical interpretation also finds direct support in paragraph 17 of *United Manganese*, which identifies legislative history, reports of commissions of inquiry, and specialised drafting committees as legitimate sources of interpretative context. Lastly, *Endumeni's* broader contextual approach, which permits the consideration of relevant external material where appropriate, can also be understood to allow comparative interpretation (also known as transnational contextualisation). Transnational contextualisation is interpreting a provision in the light of international law and its comparative provisions in other legal systems.[42] By incorporating insights from other jurisdictions, transnational contextualisation ensures that

32 *Endumeni* para 18.
33 Du Plessis 1998 *Acta Juridica* 14.
34 *Endumeni* para 18; *United Manganese* para 17.
35 Du Plessis 1998 *Acta Juridica* 14.
36 *Endumeni* para 18.
37 Van Staden *Identification of the Parties to the Employment Relationship* 22.
38 Du Plessis 2005 *SALJ* 607.
39 *Endumeni* para 18.
40 Du Plessis 2005 *SALJ* 609-610.
41 Du Plessis 1998 *Acta Juridica* 15-16.
42 Du Plessis 2005 *SALJ* 601.

statutory meaning is informed by broader legal trends and principles.[43] If a South African statute is explicitly modelled on a foreign statute, the latter possibly also falls under the banner of "legislative history" or "background".[44]

This study applies the augmented Savignian Model as a classificatory framework to structure the discussion of the interpretative process, with the aim of facilitating the systematic and clear application of *Endumeni's* interpretative guidelines. By categorising *Endumeni's* core principles – text, context, and purpose – into distinct but interconnected interpretative methods, this model provides a structured approach to legal interpretation.[45] The modes of interpretation comprising the augmented Savignian Model were recognised by the Constitutional Court in *S v Makwanyane,* demonstrating their relevance within the framework of South African legal interpretation.[46]

Note that while traditional interpretative methods often relied on a fixed order of priority, the *Endumeni* approach is presented as a unitary method of interpretation, where the triad of text, context and purpose should be applied holistically rather than mechanically.[47] It eliminates the traditional hierarchy of interpretative methods.[48] The augmented Savignian Model and the *Endumeni* approach align in their shared rejection of a rigid hierarchy in interpretative methods because the former also encourages:

> reliance on a multiple or many-sided strategy of interpretation, recognising as co-equal the grammatical, contextual, purposive and historical dimensions of statutes and the Constitution. This means that there will no longer be a need for an order of primacy, premised on the sustainability of clear and unambiguous language … the four/five methods are classificatory aids encouraging the interpreter to take the fullest possible look at the text to be construed - nothing more and nothing less.[49]

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43 After all, the *Endumeni* judgment itself is "comprehensively argued and justified by a discussion of the most important global trends in legal interpretation" (Le Roux 2019 *PELJ* 2).

44 See Du Plessis *Re-Interpretation of Statutes* 264-266, 273.

45 The augmented Savignian Model has previously been used to organise the canons of statutory interpretation in a coherent, logical and methodical way (see Du Plessis 2005 *SALJ* 601).

46 *S v Makwanyane* 1995 6 BCLR 655 (CC) para 266; Legwaila and Ngwenya 2013 *De Jure* 1071; Klaasen 2017 *De Jure* 10.

47 *Capitec Bank Holdings v Coral Lagoon Investments 194 (Pty) Ltd* 2021 3 All SA 647 (CC) para 25.

48 Le Roux 2019 *PELJ* 5; Wallis 2019 *PELJ* 14.

49 Du Plessis *Re-Interpretation of Statutes* 130-131. Also see Moosa 2018 *SA Merc LJ* 75-76, for a discussion of the interconnected reading strategies that make up the model, all of which may be applied during a single interpretative process.

3 Re-assessing the pre-constitutional interpretation of the phrase "by reason of" in section 7(3) to determine whether it aligns with contemporary interpretative principles

3.1 Grammatical interpretation

In the interpretative process the inevitable point of departure is the language of the provision.[50] The purpose of starting with the text is to limit the number of possible meanings that the language of a legislative text can generate.[51] Although language is not the ultimate determinant of the meaning of a legal text,[52] the Constitutional Court has declared that section 39(2) of the *Constitution* contains a textual threshold[53] which requires that the text must be "reasonably capable" of bearing the proposed construction.[54] In *Daniels v Cambell*[55] Moseneke J also confirmed that the construction must not be "fanciful" or "far-fetched" but must reasonably arise from the text without doing violence to the language. In his own commentary on *Endumeni*, Wallis also states with absolute clarity that:

> there is a line to be drawn beyond which the interpreter cannot go. Context cannot be used to create a meaning that language, when viewed in context, is incapable of bearing. That is not interpretation. It is contractual or legislative drafting.[56]

Section 7(3) of the *1962 ITA* reads as follows:

> Income shall be deemed to have been received by the parent of any minor child or stepchild, if by reason of any donation, settlement or other disposition made by that parent of that child –
>
> (a) it has been received by or has accrued to or in favour of that child or has been expended for the maintenance, education or benefit of that child; or
>
> (b) it has been accumulated for the benefit of that child.

The phrase *by reason of* is an idiom; that is, a collocation of words of which the meaning "is not reducible to a synthesis of the respective meanings of each of the words taken in isolation".[57] The meaning of the phrase *by reason of* can be broken down as follows:

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50 *Endumeni* para 18.
51 Du Plessis *Re-Interpretation of Statutes* 197.
52 Du Plessis 1998 *Acta Juridica* 14.
53 Le Roux 2006 *SAPL* 383.
54 *Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs and Tourism* 2004 7 BCLR 687 (CC) para 72.
55 *Daniels v Cambell* 2004 7 BCLR 735 (CC) para 83.
56 Wallis 2019 *PELJ* 14.
57 Ross 2004 *Stell LR* 271.

(a) *by reason of* means *because of*. "If one thing happens by reason of another, it happens because of it."[58]

(b) *because of* means: "[i]f an event or situation occurs because of something, that thing is the reason or cause."[59]

Within the context of section 7(3), the words *by reason of* indicate that the income in question must have been caused by the parent's DSOD. What remains unclear is whether the DSOD must be *the* or *a* cause of the income.

3.1.1 A "the cause" interpretation

If the parent's DSOD must be *the cause* of the income received by the minor child, "*the*" might indicate that it must be the *sole* cause of the income*, sole* "being the only one; only".[60] In law, *sole cause* means: "[t]he only cause that, from a legal viewpoint produces an event or injury".[61] Therefore the DSOD must be selected from various contributing causes as being the *sole* (only) cause on some or other ground, presumably by bearing certain characteristics such as being in close proximity to or having significantly contributed towards the earning of the income in some way. Such an interpretation acknowledges that the income may be the product of several causes out of which one must be selected as the legally operative cause. This type of causal reasoning is ubiquitous in our law and is *inter alia* applied in the law of delict, criminal law and insurance law.

In *Kohler* Murray J indicated that arguments advanced on behalf of the Commissioner and the taxpayer were formulated with reference to case law on the question of causation in delict.[62] These causation principles also formed the basis of the taxpayer's argument in *Widan*. In the law of delict, causation comprises two components, *viz* factual and legal causation,[63] that are used to distinguish legally operative from legally inoperative (remote) causes.

South African courts generally apply the *conditio sine qua non* test (the "but for" test) to establish factual causation.[64] The "but for" test is applied by hypothesising what would have happened "but for" the conduct of the

58 Collins English Dictionary date unknown https://www.collinsdictionary.com/dictionary/english/by-reason-of.
59 Collins English Dictionary date unknown https://www.collinsdictionary.com/dictionary/english/because-of.
60 Collins English Dictionary date unknown https://www.collinsdictionary.com/dictionary/english/sole.
61 Garner *Black's Law Dictionary* "sole cause".
62 *Kohler* 316.
63 Loubser *et al Law of Delict* 70.
64 Loubser *et al Law of Delict* 71; *Fourway Haulage v SA National Roads Agency* 2009 1 All SA 525 (SCA) para 30.

defendant.[65] If the defendant's conduct is mentally eliminated and the harm would not have occurred "but for" the defendant's conduct, the conduct is a *conditio sine qua non* (or necessary condition) of the harm. Once a court finds that the defendant's conduct satisfies the test for factual causation, a second problem arises,[66] namely whether and to what extent the defendant should be held liable for the consequences his actions helped to produce.[67] This enquiry into legal causation seeks to separate the consequences defendants *ought* to be held liable for from those they *ought not* to be held liable for.[68] Establishing legal causation involves making various choices in which legal policy and value judgments are used to balance the plaintiff's interests in receiving compensation for losses suffered with the need to avoid imposing an excessive burden on the defendant.[69]

In both *Kohler* and *Widan* each parent argued that his DSOD was merely the *causa sine qua non* and not the proximate cause of his minor children's income. The proximate cause test (or direct consequences theory) is employed to establish legal causation.[70] Under this theory defendants are held liable for the consequences (harm) that followed directly from their agency, if they should reasonably have foreseen that the harm would follow from their conduct.[71] The only way for defendants to escape liability is for a *novus actus interveniens* to break the causal relationship between their conduct and its consequences.[72] A *novus actus interveniens* is an independent, unconnected and extraneous causative factor or event[73] which completely neutralises the causative potency of an earlier cause.[74]

In *Kohler* the taxpayer argued that the operation of section 9(3) required the existence of a direct and immediate causal relationship between the sub-income and his DSOD. It was further argued that the phrase *by reason of* must be construed as referring to the proximate cause of the sub-income and not merely to a *causa sine qua non* of such income. According to the taxpayer, the reinvestment decision was a *novus actus interveniens* which severed the causal relationship between the earlier cause (the DSOD) and the result (the sub-income) and in so doing became the proximate cause (the legally operative cause) of the sub-income. The Commissioner

65 *International Shipping Co (Pty) Ltd v Bentley* 1990 1 All SA 498 (A) 516 (hereafter *Bentley*).
66 *Bentley* 517.
67 Midgley "Delict" 175.
68 Boberg *Law of Delict* 440.
69 Midgley "Delict" 175; *Muller v Mutual and Federal Insurance Co Ltd* 1994 1 All SA 199 (C) 225-226.
70 Loubser *et al Law of Delict* 94.
71 Loubser *et al Law of Delict* 95.
72 Loubser *et al Law of Delict* 95.
73 *Tuck v CIR* 50 SATC 98 (hereafter *Tuck)* 113.
74 Midgley "Delict" 184.

effectively contended that proximate cause should not be interpreted as the immediate or nearest cause to a result (the sub-income), and further that intended consequences can never be too remote to impute.

In *Napier v Collett*[75] Grosskopf JA stated that the Appellate Division had over the years analysed the issue of causation in several different contexts, namely criminal law, law of delict and law of insurance.

> Despite the differences between various branches of the law, the basic problem of causation is the same throughout. The theoretical consequences of an act stretch into infinity. Some means must be found to limit legal responsibility for such consequences in a reasonable, practical and just manner.[76]

It may therefore be argued that the phrase *by reason of* implicitly attracts the common law principles of legal causation and the fact that these principles originated in and are usually applied in other spheres of law does not necessarily stand in the way of their acceptance into Income Tax law.[77]

According to Honoré there are at least two non-causal factors which prevent the indefinite extension of legal responsibility, namely "the scope and purpose of the rule of law in question"[78] and "the aspiration of the law to achieve results that are morally unobjectionable".[79] The precept of proximate cause expresses a normative preference as to how far liability *ought* to extend.[80]

A "*the cause*" interpretation would therefore not only allow, but also require, a consideration of the purpose of section 7(3) to establish its scope of operation but would incorporate an element of moral-based reasoning in accordance with section 39(2) of the *Constitution*.

3.1.2 An "a cause" interpretation

If the DSOD must be "*a cause*", "*a"* might indicate that it must merely be *one* of the causes of the income. This means that once it has been

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75 *Napier v Collett* 1995 2 All SA 457 (A) (hereafter *Napier*).

76 *Napier* 457-458.

77 Note that the principles of legal causation have been applied in other income tax contexts – for example, in *CIR v Shell Southern Africa Pension Fund* 1984 1 All SA 474 (A) 477-478 and *Millin v CIR* 3 SATC 170. In *Tuck* 113-114, Corbett JA expressed doubt about the appropriateness of applying causation principles from criminal law and delict to characterise the nature of a receipt. Instead, he adopted a different test to decide the case. However, he later acknowledged that applying the principles of legal causation would have led to the same conclusion. The reservations expressed by Corbett JA in *Tuck* do not amount to an outright rejection of applying the principles of legal causation in an income tax context; rather, he cautioned that their application depends on the wording of the specific provision in question (Singleton 2004 *Tax Planning Corporate and Personal* 66).

78 Honoré 2010 https://plato.stanford.edu/archives/win2010/entries/causation-law/.

79 Honoré 2010 https://plato.stanford.edu/archives/win2010/entries/causation-law/.

80 Sperino 2013 *Notre Dame L Rev* 1202.

determined that the parent's DSOD is a factual cause of the income, that is the end of the matter and section 7(3) applies. From the outset, this form of causal reasoning does not require a consideration of the purpose of section 7(3), nor does it allow for the making of legal policy judgments or moral evaluations. This is so because the enquiry into the causal connection begins and ends with establishing factual causation and the consideration of non-causal factors has no bearing on the decision of whether income falls within the scope of section 7(3).

3.1.3 Conclusion: "the cause" vs "a cause" interpretation

Although the phrase *by reason of* is linguistically capable of meaning that the parent's DSOD must be either *the cause* or *a cause* of the income, the preferred interpretation must be *the cause*. This alternative allows for the consideration of the purpose of section 7(3) and the moral values underlying our legal system to determine the meaning of the phrase and consequently whether sub-income is within the scope of section 7(3) decisively.

In *Widan* the AD held that the phrase *by reason of* presupposes the existence of some causal relation between the parent's DSOD and the income in question. The income is *by reason of* the parent's DSOD, if based on the facts of the case the DSOD is the *effective cause* thereof. It is unfortunate that Centlivres CJ seemingly used the terms "proximate", "effective" and "efficient" cause interchangeably. Based on his use of these terms, it is contended that there is no difference between them. Legal dictionaries indicate that an "efficient" cause is also described as a "proximate" or "legal" cause.[81] The AD therefore, in effect, adopted *the cause* interpretation that is supported by a grammatical reading of section 7(3).

3.2 Systematic, teleological and historical interpretation

In the research method section, systematic, teleological, and historical interpretation were described as three different but related modes of interpretation. In this section these modes are applied simultaneously to avoid unnecessary duplication on account of the significant overlap among them.

According to Du Plessis,[82] systematic and teleological interpretation are intertwined. "Systematic interpretation amounts to contextualisation."[83] Contextualising a provision requires that it be interpreted in the light of the other provisions of the same Act and within its broader statutory context.[84]

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81 Garner *Black's Law Dictionary* "efficient".

82 Du Plessis 2005 *SALJ* 604.

83 Du Plessis 2005 *SALJ* 603.

84 De Ville *Constitutional and Statutory Interpretation* 159. This broadly agrees with what was said in *Endumeni* para 18: "having regard to the context provided by

The broader statutory context of a provision includes the supreme *Constitution* and other relevant law, which Botha[85] describes as the "bigger picture". It follows that systematic interpretation amounts to the contextualisation of a provision with a view to harmonising it with the other provisions of the same enactment and with its extra-textual context.

"Teleological interpretation is purposive interpretation attributing meaning to a provision mindful of both its (possible) objective(s) or ratio, and of [the] aspirational values of the legal system as a whole."[86] The *Constitution* is the fundamental and authoritative source of the aspirational values of our legal system.[87] De Ville[88] discusses teleological interpretation under the heading "contextualisation" because the purpose of the legislation and the values underlying it provide context for clarifying the intended scope and effect of the provision at hand.

Historical interpretation can also be linked with teleological interpretation because it involves the consideration of the historical context of a provision. Consequently, "[t]he historical context includes factors such as the circumstances that gave rise to the adoption of the legislation (mischief rule) and the legislative history (prior legislation and preceding discussions)".[89] Teleological interpretation which lacks a historical foundation is "in fact empty".[90]

> The provision to be construed is perceived as a response to a mischief that existed in a given historical situation and that situation, as well as the law as it then stood, must be appreciated in order to fully apprehend the effects of the provision as the measure aimed at redressing it.[91]

In South Africa historical interpretation has been likened to genetic interpretation whereby the interpreter considers the genesis or the history of the wording of the enacted text.[92] Historical interpretation is performed simultaneously with systematic and teleological interpretation because, as Du Plessis explains, it is not a primary mode of interpretation but is applied to inform and confirm the results of the other reading strategies.[93]

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reading the particular provision or provisions in light of the document as a whole". Also refer to the more detailed description of context in relation to statutes in *United Manganese* para 17.

85 Botha *Statutory Interpretation* 129.

86 Du Plessis 2005 *SALJ* 607.

87 Du Plessis 2005 *SALJ* 608.

88 De Ville *Constitutional and Statutory Interpretation* 244.

89 Botha *Statutory Interpretation* 108.

90 Du Plessis *Re-Interpretation of Statutes* 256.

91 Du Plessis *Re-Interpretation of Statutes* 256.

92 Du Plessis *Re-Interpretation of Statutes* 259.

93 Du Plessis *Re-Interpretation of Statutes* 267. Also see *United Manganese* para 17 – legislative history *may* provide useful background to resolve interpretational

3.2.1 Section 7(3)'s interrelated provisions and broader statutory context

No tax can arise unless a taxable object is attributed to a taxable subject.[94] In terms of section 5(1) of the *1962 ITA*, normal tax is levied on the taxable income received by or accrued to or in favour of a natural person on an annual basis for the benefit of the National Revenue Fund. Taxable income is the residual amount of receipts and accruals after the elimination of exemptions, deductions and certain capital amounts. It follows that if a receipt or accrual is not included in a person's taxable income, it will not attract normal tax.

Section 7 of the heading of the *1962 ITA* reads: "[w]hen income *is deemed* to have been accrued or to have been received" (own emphasis). "If something is deemed to have a particular quality or to do a particular thing, it is considered to have that quality or do that thing".[95] Under section 7 an amount may therefore be considered to have the quality of a receipt or accrual if the circumstances of its subsections apply. An amount may therefore attract normal tax in the hands of a person to whom section 7 applies and who has neither received it on his or her own behalf for his or her own benefit, nor is unconditionally entitled to it under the general meaning of the terms "received by" or "accrued to".

In terms of proviso (i) to section 90 of the *1962 ITA*, the donor parent is given the right to recover the normal tax paid in respect of a section 7(3) deemed inclusion from the minor child.

3.2.2 Section 7(3)'s purpose

Section 5(1)(c) of the *1962 ITA* read with schedule I (wherein the normal tax rates for natural persons are given) makes it clear that policy-makers elected the individual as the tax unit for the purposes of levying the normal tax charge. When there are sound policy reasons for electing the individual (as opposed to a family) as the tax unit, there must also be rules to assign income to the appropriate family member, and these rules must be observed.[96] Given that the individual was chosen as the tax unit, allowing income splitting would undermine that policy choice because taxpayers would effectively "self-select" a joint tax unit.[97]

South Africa's normal tax rate structure for natural persons is progressive because the tax rate increases as the amount of taxable income

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uncertainties and the reports of commissions of enquiry *may* provide helpful context (own emphasis).

94 Salom 2011 *Bulletin for International Taxation* 394.

95 Collins English Dictionary date unknown https://www.collinsdictionary.com/dictionary/english/deem.

96 Loutzenhiser *Income Splitting, Settlements and Avoidance* 58.

97 Loutzenhiser *Income Splitting, Settlements and Avoidance* 58, 131.

increases.[98] The justification for a progressive tax rate structure is the concept of "vertical equity",[99] which requires that taxpayers of unequal means (in dissimilar circumstances) should pay unequal amounts of tax.[100] It follows that vertical equity allows for a tax system to discriminate between taxpayers of different means for the purpose of redistributing resources between rich and poor.[101] If a parent with a high tax rate splits income with a minor child with a comparatively lower tax rate, their collective income tax liability is reduced. The self-selection of a joint tax unit, therefore, undermines the integrity of South Africa's progressive normal tax rate structure and the policy objective of redistributional justice.

Upon reading section 7(3) and proviso (i) to section 90 together, it may be argued that the purpose of section 7(3) is not necessarily to shift the incidence of normal tax on the section 7(3) income from the minor child to the donor parent, but to ensure that the section 7(3) income is taxed at the donor parent's tax rate. Anti-avoidance provisions (such as section 7(3)) generally have an ascertainable purpose which must be given effect to.[102] However, the importance of applying the ascertained purpose in a manner that conforms to the values and rights underlying the supreme *Constitution* on account of section 39(2) cannot be over emphasised. This is what distinguishes "teleological" from "ad hoc purposive" interpretation. Mureinik[103] warns that a purposive interpretation can promote inequity if the policy objective of a statute is iniquitous. Devenish[104] similarly rejects ad hoc purposivism on the basis that "it can neglect certain critically important values". Teleological interpretation requires an objective determination of the purpose of a legal text.[105] Thereafter the consequences of the objectively identified purpose must be applied in a manner that accords with the fundamental values enshrined in the *Constitution*.[106]

It has previously been suggested that the purpose of section 7(3) is to ensure that a minor child's income that is derived *by reason of* a parent's DSOD is taxed at the donor parent's tax rate. Progressive tax rate structures

98 Croome *Taxpayer's Rights in South Africa* 99.
99 Loutzenhiser *Tiley's Revenue Law* 17.
100 Loutzenhiser *Tiley's Revenue Law* 11.
101 Kirkbride and Olowofoyeku *Law and Theory of Income Tax* 8.
102 Cilliers "Tax Avoidance and the Interpretation of Fiscal Statutes" §46.3. The apparent purpose to which a provision is directed was also explicitly referenced as forming part of the interpretative framework in *Endumeni* para 18. Note that in a tax context one cannot argue that a provision must be given a construction that favours the *fiscus* on the grounds that the purpose of a taxing act is to raise revenue, however an anti-avoidance provision may warrant a more generous construction than one which defines taxable income (Wallis 2019 *PELJ* 17).
103 Mureinik 1986 *SALJ* 624.
104 Devenish 2006 *SALJ* 400.
105 Devenish 2006 *SALJ* 406.
106 Devenish 2006 *SALJ* 406.

impose higher taxes on individuals with higher taxable incomes. It is submitted that for a provision aimed at protecting the progressive tax rate structure to be constitutionally defensible, the underlying progressive tax rate structure itself must also be constitutionally defensible. This is because any provision that differentiates between taxpayers based on income or other factors must comply with constitutional protections such as the right to equality, which is discussed further below. In other words, the legitimacy of a provision protecting the progressive tax rate structure is tied to the constitutional defensibility of the structure itself, which must not violate a taxpayer's right to equality.

Section 9(1) of the *Constitution* provides that: "everyone is equal before the law and has the right to equal protection and benefit of the law". Section 9(3) of the *Constitution* prohibits discrimination on the seventeen grounds listed therein. A taxpayer's right to equality is, however, not absolute and may be limited by section 9(5) or section 36 of the *Constitution*. Croome[107] argues that a constitutional challenge of the progressive income tax rate structure on the basis that it violates a taxpayer's right to equality is likely to fail.

> The Government has a number of instruments to set fiscal policy, one being the rate at which tax is payable, another being the base on which that tax is payable. States around the world impose various taxes at different rates to fund public expenditure and it is submitted that if the imposition of income tax at progressive rates were held to be discriminatory in nature such conduct would not unlawfully violate s 36 of the Constitution. The state needs to have the flexibility to impose at different rates depending on the nature of the taxpayer and the level of income derived by the taxpayer.[108]

According to Barker[109] "[e]quality in taxation stands squarely on the shoulders of a progressive movement in taxation that asserts that the political goals of taxation are substantive equality and redistributional justice". If a progressive tax rate structure is therefore probably not unconstitutional, and moreover generally considered desirable as an instrument of income distribution (especially in South Africa, where wealth and income inequality levels are high), it follows that an anti-avoidance provision (such as section 7(3)), which is designed to protect the integrity of the progressive normal tax rate structure, has a rational, reasonable and constitutionally defensible purpose. However, on account of section 39(2) of the *Constitution*, the effect of applying section 7(3) must be compatible with the *Constitution* and its underlying values.[110]

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107 Croome *Taxpayer's Rights in South Africa* 101.
108 Croome *Taxpayer's Rights in South Africa* 101.
109 Barker 2009 *Loy U Chi LJ* 234.
110 Devenish 2006 *SALJ* 406.

3.2.3 The compatibility of the effect of applying section 7(3) with the values underlying the supreme Constitution

The consequence of the application of section 7(3) (or its operational effect) is that one taxpayer (the parent) may be liable to pay tax on income that legally belongs to another (the minor child). A parent may in terms of proviso (i) to section 90 recover the tax so paid from the minor child, but the parent is nevertheless taxed on the section 7(3) income irrespective of when or if the tax will be recovered.

In accordance with section 9(1) of the *Constitution* all persons are equal before the law, and section 9(3) of the *Constitution* provides that the state may not unfairly discriminate against anyone on specified listed grounds, which include age. Why should a minor child not be liable to tax on amounts received by or accrued to him or her in the same manner as any other taxpayer? During the debate on 8 July 1925 on the *Income Tax Bill* of 1925 in which the ultimate predecessor of section 7(3)[111] was under discussion, CWA Coulter MA (ultimately arguing against its adoption) in a question to the Minister of Finance asked: "[w]hy, I ask him does he select a donation to a minor child? What is the logical difference between a minor and major child?".[112]

Major taxpayers are taxed on the income to which they are entitled irrespective of whether such income was derived *by reason of* a parent's DSOD. If section 7(3) is applied the result is that a minor child's income that is derived *by reason of* a parent's DSOD is taxed in the hands of the donor parent (who is not entitled thereto).

Presumably the purpose of proviso (i) to section 90 is to rectify this apparent inequality by allowing the parent to recover the tax paid by him or her due to the operation of section 7(3). But this right to recovery does not detract from the argument that section 7(3) differentiates between categories of people because section 7(3) can apply irrespective of when or if the tax will be recovered, and it causes income which belongs to the minor child to be taxed at the parent's (and not the child's) marginal tax rate. Because a minor child's income that falls outside section 7(3) is taxed in the minor child's own hands, the purpose of section 7(3) cannot be to shift the burden of tax compliance from the minor child to the parent, and is therefore not considered to be the rationale for the differentiation.

The idea that like should be treated alike is not foreign to income tax law and finds expression in the precept of "horizontal equity". According to Swart[113] "[t]he use of the tax precept of horizontal equity as a constitutional

111 Section 9(3) of the *Income Tax Act* 40 of 1925 (hereafter *1925 ITA*).
112 House of Assembly *Debates 1925* 5696.
113 Swart 1995 *THRHR* 660.

norm in income tax law accords with the spirit and purport of the Constitution". He submits that the precept of horizontal equity expresses the fundamental constitutional values of equality and fairness.[114] Botha, Meyer and Kok[115] suggest that the precept of horizontal equity could also be helpful to give practical effect to the requirement of rationality in an income tax context. Horizontal equity is achieved if taxpayers in similar positions bear similar tax burdens.[116] If horizontal equity is taken as a constitutional requirement in an income tax context (as Swart[117] suggests it should), one might argue that all taxpayers should be taxed on their own income.

Differentiation does not violate section 9(1) of the *Constitution* if the differentiation has a rational connection with a legitimate government purpose.[118] It has previously been suggested that section 7(3) has a legitimate government purpose, namely: to protect the integrity of South Africa's progressive normal tax rate structure. However, differentiation that promotes a legitimate government purpose could nevertheless amount to discrimination.[119] Differentiation on one of the grounds prohibited by section 9(3) of the *Constitution* amounts to discrimination, which is presumed to be "unfair".[120] In terms of section 9(5) of the *Constitution* discrimination on a listed ground (such as age) is presumed to be unfair unless it is established to be fair.[121] Discrimination is unfair if it has an unfair impact on the victim of the discrimination.[122]

In *Harksen v Lane*[123] the Constitutional Court listed various factors that must be considered to establish whether a discriminatory provision unfairly impacts on the victims thereof. These factors include a consideration of the nature and purpose of the discriminatory provision.[124] The Constitutional Court said that if the purpose of the provision is not directed at impairing the human dignity of the victims but is directed at achieving a valid and important societal goal, such as the furtherance of equality, it may lead the court to conclude that the discrimination in question is fair.[125] "The more important and pressing the purpose of the discrimination is, the more likely that a court will find the discrimination to be fair."[126]

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114 Swart 1995 *THRHR* 647.
115 Botha, Meyer and Kok 2020 *SA Merc LJ* 10.
116 Legwaila and Ngwenya 2013 *De Jure* 1072.
117 Swart 1995 *THRHR* 648.
118 Currie and De Waal *Bill of Rights Handbook* 216.
119 Currie and De Waal *Bill of Rights Handbook* 216.
120 Currie and De Waal *Bill of Rights Handbook* 216.
121 Croome *Taxpayer's Rights in South Africa* 101.
122 Currie and De Waal *Bill of Rights Handbook* 225.
123 *Harksen v Lane* 1997 11 BCLR 1489 (CC) (hereafter *Harksen)*.
124 *Harksen* para 51.
125 *Harksen* para 51.
126 De Vos *et al South African Constitutional Law in Context* 451.

Almost all governments have recognised the threat that tax avoidance poses to democratic societies.[127] Barker[128] effectively argues that the outcome of tax avoidance behaviour (which undermines progressive income tax systems by shifting tax liability to those who are least able to pay it), promotes the liberty of the individual at the expense of the individual and collective value of equality. It could be argued that section 7(3) has an important and pressing purpose, namely to protect the integrity of our progressive income tax system by countering tax avoidance behaviour that undermines fair and equitable taxation in accordance with a taxpayer's ability to pay. The operational impact of section 7(3) depends on the donor parent's financial position. However, the fact that proviso (i) to section 90 allows the donor parent to recover the tax paid from the minor child should (in theory) mitigate the adverse financial impact that section 7(3) could have on the donor parent's financial position. Nevertheless, if the age-based discrimination brought about by section 7(3) is found to be unfair because it has an unfair impact, section 36(1) of the *Constitution* must still be considered.[129]

Section 36(1) of the *Constitution* provides that the fundamental rights may be limited: "in terms of a law of general application to the extent that the limitation is reasonable and justifiable in an open and democratic society". Section 7(3) is contained in a law of general application and the revenue authorities would probably be able to show that the age-based discrimination caused by it is not an unlawful violation of the constitutional right to equality.

First, it could be argued that the fact that section 7(3) applies to the offending income of minor children only is justifiable and reasonable because parents have a legal responsibility to provide for the maintenance, education and care of their minor children. Section 1(1) read together with section 18(2) of the *Children's Act* 38 of 2005 (hereafter the *Children's Act*) includes contributing to the maintenance of a child among parental responsibilities. "Food, clothing, accommodation, medical care and a suitable education are all included in maintenance."[130] Section 1(1) of the *Children's Act* defines a child as a person under the age of 18 years. "As a general rule parental responsibilities and rights terminate when the child attains majority."[131]

In the House of Assembly Debate on 20 May 1932, the Minister of Finance, discussing the proposed amendment of section 9(3), said that:

127 Barker 2009 *Loy U Chi LJ* 229.
128 Barker 2009 *Loy U Chi LJ* 232.
129 Currie and De Waal *Bill of Rights Handbook* 216-218.
130 Heaton and Kruger *South African Family Law* 303.
131 Heaton and Kruger *South African Family Law* 351.

> [a]nother important clause is Clause 4, which remedies a defect in section 9(3) of the existing Income Tax Act. It has become a growing practice for parents to form trust funds for the benefit of their minor children. The income of the fund is either for the children, or as frequently happens is used for their education and maintenance. In either case hon. members will appreciate, it is really setting aside a portion of the parents' income for the children.[132]

Arnold[133] claims that parents would not forego the control over and the direct receipt of such income as exceeds the total amount of income they would otherwise have provided to their dependants (their minor children) from their own resources. He argues that:

> [p]rior to the creation of the trust, the parent grantor retained the source of the income and provided for expenditures of his dependents from his own resources. Transferring the legal title to the income-producing property to the trustee in no way alters the ultimate distribution of the economic benefits – the beneficiary received the same income before and after the transaction. Thus, the parent's actions in establishing the trust should be taken to indicate that he would otherwise provide the income from his own resources in the absence of the transfer in trust.[134]

Based on the above, Arnold[135] suggests that it is the donor parents who realise a taxable economic benefit from income placed in trust to fund their minor children's expenditures to the extent that they would otherwise have to provide for those expenditures from their own funds. It follows that when parents "set aside" a portion of their income (either by making a DSOD of income or income-generating assets) in favour of their minor children, they are still in fact the *de facto* beneficiaries of the income received by the minor children because of their obligation to provide for the care, maintenance and education of those children. Parents' normal tax rates should not be impacted by their choice to provide for the education and maintenance of their minor children directly from their own funds or indirectly from the funds donated ("set aside") for the benefit of their minor children. If the parent does realise the economic benefit of the income "set aside", it is reasonable that such income be taxed at the parent's normal tax rate.

Second, age differs from most of the other grounds of discrimination in that it does not refer to an unchanging characteristic.[136] It could therefore be argued that the age-based discrimination brought about by section 7(3) is temporary, since section 7(3) ceases to operate once the minor child reaches majority. Temporary discrimination based on a changing characteristic might be more easily justifiable in terms of section 36(1) than would discrimination based on an unchanging characteristic.

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132 House of Assembly *Debates 1932* 5023.
133 Arnold 1973 *S Cal L Rev* 172.
134 Arnold 1973 *S Cal L Rev* 173.
135 Arnold 1973 *S Cal L Rev* 174-175.
136 Currie and De Waal *Bill of Rights Handbook* 233.

Third, there are similar anti-avoidance measures to section 7(3) in other open and democratic societies.[137] The fact that similar anti-avoidance measures do exist in other jurisdictions suggests that they are probably not unreasonable or unjustifiable in open and democratic societies.

Fourth, tax avoidance creates inequality of opportunity,[138] as only the "well-to-do" and "well-informed" taxpayers can realise any advantage from it.[139] It may therefore be argued that income-splitting activities should not be allowed because only those parents who have the means to donate income or income-producing property and who have access to tax planning services can engage in such activity. According to Barker[140] "[m]any perceive legislation in general, and tax legislation even more so, as being the result of political compromise without any claim to universal truth". The ideological support for tax avoidance activities derives from taxpayers' conceptions of their rights to liberty, including freedom from government interference, freedom to own their property and the freedom to contract.[141] The following statements by CWA Coulter MA regarding the adoption of the ultimate predecessor of section 7(3)[142] are to this effect:

> (a) This is an unjustifiable interference with the legitimate exercise in the past by people of their right to make settlements.[143]
>
> (b) It is unreasonable to penalize persons who have acted fully within their rights in parting with their assets. It cannot be put right once they are invested with the trustees.[144]
>
> (c) I cannot understand, if a man does a perfectly legitimate thing in making a donation for his children why that should be regarded as evasion. The Minister feels it is evasion[145] because in the case of the wealthy parents the liability for super-tax is diminished.[146]

Barker[147] argues that the idea of liberty in the context of taxation masks the goal of the rich to re-establish their tax burden (as determined by the democratically elected government) onto the shoulders of others. He

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137 See 3.3 below.
138 Barker 2009 *Loy U Chi LJ* 239.
139 Barker 2009 *Loy U Chi LJ* 240.
140 Barker 2009 *Loy U Chi LJ* 238.
141 Barker 2009 *Loy U Chi LJ* 234.
142 Section 9(3) of the *1925 ITA*.
143 House of Assembly *Debates 1925* 5845.
144 House of Assembly *Debates 1925* 5695.
145 Tax avoidance is generally distinguished from tax evasion on the grounds that the latter is illegal (Loutzenhiser *Tiley's Revenue Law* 99). Throughout the House of Assembly Debates, the members refer to income splitting activities as constituting "tax evasion" as opposed to "tax avoidance". Stopforth 1987 *British Tax Review* 417 explains that the distinction between tax evasion and tax avoidance was not made prior to 1936 and that reference was often made to "tax evasion" when a person meant to refer to what is nowadays called "tax avoidance".
146 House of Assembly *Debates 1925* 5695.
147 Barker 2009 *Loy U Chi LJ* 234.

contends that equality is more than an ideology; it is in fact the purpose behind the adoption of income tax law:

> [t]he purpose of the legislation, taxation in accordance with ability to pay, is as much a part of the law as the language of the text itself. In contrast, liberty uses the ideology of formal equality, or equality before the law, as a mask for one class's political goal of shifting the burden of any significant taxes from the few to the many…[148]

Section 7(3) is designed to nullify the tax benefits that would in its absence be available to parents who are willing and able to engage in income splitting activities. In this context section 7(3) promotes substantive as opposed to formal equality between parents. Formal equality requires that all persons be treated alike by extending the same rights to all without cognisance of the actual social and economic disparities between them.[149] It follows that allowing a "well-to-do" parent to split income with his or her minor children when a "less well-to-do" parent cannot do so does not violate formal equality because in theory the opportunity to do so is available to both parents. However, section 9(1) of the *Constitution* calls for substantive and not formal equality.[150]

"Substantive equality requires the law to ensure equality of outcome and is prepared to tolerate disparity of treatment to achieve this goal."[151] Section 7(3) promotes equality of outcome by ensuring that the way parents choose to fulfil their obligation of providing for the maintenance, education and care of their minor children does not affect the rate their income is taxed at. The "disparity of treatment" between major and minor taxpayers brought about by the application of section 7(3) promotes substantive equality, in which case it is probably reasonable and justifiable in our open and democratic society.

The phrase *by reason of* is one of the primary determinants of the scope of section 7(3). Any income derived by a minor child that is not *by reason of* a parent's DSOD cannot be imputed to the donor parent. It has been suggested that the phrase *by reason of* implicitly attracts the common law principles of legal causation,[152] and it has been explained that legal causation:

(a) is a measure of control that the courts use to balance the interests of a wrongdoer and the victim on an equitable basis;

148 Barker 2009 *Loy U Chi LJ* 235.
149 Currie and De Waal *Bill of Rights Handbook* 213.
150 Currie and De Waal *Bill of Rights Handbook* 214.
151 Currie and De Waal *Bill of Rights Handbook* 213.
152 See 3.1.1 above.

(b) is used to determine what consequences the wrongdoer *ought to* be held liable for without imposing an excessive burden on him or her; and

(c) serves a limiting function and is an articulation of policy choices as to whether the scope of liability should be limited, based on the principle that liability cannot reasonably extend indefinitely and that some consequences are "too remote" for legal liability to ensue.

Within the context of section 7(3), the wrongdoer is presumably the parent (who contrary to the wishes of policymakers and to the detriment of the fiscus) makes a DSOD in favour of his or her minor children. The victim is presumably other taxpayers and society at large because tax avoidance behaviour (including income-splitting practices) frustrates the collection of the revenue that the government needs to fulfil its constitutional responsibilities.

Barker[153] also argues that: "[f]or those who primarily derive income from wages and who therefore bear the brunt of taxes, tax avoidance is not a victimless crime". The victims of income splitting are also (as has been ventured above) other parents who are not able or do not have the means to donate income-producing property to their minor children, but who are forced to maintain their children with their own funds.

It follows that the decision as to whether and in what circumstances sub-income can be imputed under section 7(3), through the interpretation of the phrase "by reason of", must strive to balance the interests of the "wrongdoer" and the "victims". This decision ought to consider the fact that not every donor parent donates income-producing property to his or her minor children to avoid or diminish his or her collective normal tax liability; there may be other valid legal or economic reasons for doing so. However, even if the parent's donation is not made with the intention of avoiding or diminishing the family unit's collective normal tax liability, the consequence of the donation could nevertheless have that effect.

It is submitted that the meaning given to the phase *by reason of* cannot as a rule exclude sub-income from the scope of section 7(3). Such an interpretation would emasculate section 7(3) instead of furthering its purpose. Moreover, such an interpretation is also inequitable, for it does not equitably balance the interests of the donor parent and the victims of tax avoidance behaviour. To achieve constitutional congruence, the interpretation must not only promote the purpose of section 7(3), but also promote substantive equality as required by the *Constitution*.

153 Barker 2009 *Loy U Chi LJ* 239.

It is also considered that because section 7(3) applies only to minor children and ceases to apply when those children reach majority, it does not allow for a parent's liability to extend indefinitely in the first place. Furthermore, the application of section 7(3) should (theoretically) not result in crippling liability for the parent, who has the right to recover the tax paid under proviso (i) to section 90. It also stands to reason that donor parents would not impoverish themselves to the extent that they are unable to settle the liability arising under section 7(3). Viewed in this light, arguments in favour of limiting the scope of section 7(3) to exclude sub-income seem less convincing.

In *Widan* Centlivres CJ said that:

> [e]very case must be decided on its own facts and if in any particular case it appears, that apart from proof of any specific intention on the part of the parent, the effective cause of the income accruing to the minor child was the donation made by the parent, then such income is deemed under section 9(3) to have been received by the parent.[154]

Accordingly, sub-income falls within the scope of (what is now) section 7(3) if, based on the facts of the case, the parent's donation is the effective cause thereof. This interpretation allows the courts to consider each case concerning the imputability of sub-income on its own merits. In each case the courts must strike an appropriate balance between the interests of the donor parent and the victims of unabated tax avoidance behaviour. Sub-income may but does not necessarily stand to be imputed to a donor parent under section 7(3). In conclusion, the AD's interpretation of the phrase *by reason of* in *Widan* is supported by a systematic, teleological and historical reading of the same.

3.3 Comparative interpretation (transnational contextualisation)

In certain instances South African statues or sections have been taken over from English law.[155] South African courts, however, need only be cognisant of the interpretation of the English courts if the South African and English legislation is identical.[156] The ultimate predecessor of section 7(3) was first included in the *Income Tax Act* 40 of 1925 (hereafter *1925 ITA*). In 1925 the Union of South Africa was still under the dominion of the British Empire and it became a Republic only in 1961. However, no evidence could be found to the effect that section 7(3) was taken over from British legislation. If it was, no mention thereof is made in the 1925 House of Assembly Debates.

The ultimate predecessor of section 7(3) was per J.W Jagger MA introduced to "meet a case tried before the courts, which the Income Tax Commissioner

154 *Widan* 352.
155 De Ville *Constitutional and Statutory Interpretation* 238.
156 Botha *Statutory Interpretation* 154.

lost".[157] The need to introduce anti-avoidance measures to counter income splitting between parents and their minor children seems to have presented itself organically, based on the activities of South African taxpayers, and not because similar measures were being considered in Britain at around the same time.[158]

The author was unable to confirm whether United Kingdom (UK) legislation was used to draft the South African legislation. However, even if it was, the wording of section 7(3) (as it is now) is not identical to that of its UK counterpart (as it reads now) in part 5 of chapter 5 of the *Income Tax (Trading and Other Income) Act* 2005 (hereafter *ITTOIA* 2005). The aforementioned anti-avoidance measures are colloquially referred to as the settlement provisions. One of the purposes of the UK settlement provisions is to restrict the income-splitting opportunities within a family unit, including income splitting between parents and their minor children.[159] In terms of the UK settlement provisions, offending income is treated as the income of the settlor for income tax purposes.[160]

The differences in the wording of and the circumstances under which section 7(3) and the *ITTOIA* 2005's settlement provisions operate suggest that section 7(3) (in its current form) was not taken over from UK tax law. It follows that the interpretations of foreign courts of the settlement provisions of the *ITTOIA* 2005 would probably be of little assistance to the interpretation of section 7(3). The important point here is that other open and democratic societies (such as the UK) have adopted similar (albeit not identical) anti-avoidance measures to counter income splitting between parents and their minor children. Based on the above, a detailed investigation of the manner in which foreign courts have interpreted the counterpart legislation in the UK of section 7(3) would not contribute towards the achievement of the research objective of this study other than by confirming that other open and democratic societies have similar anti-avoidance measures to counter income-splitting activities, in terms of which the offending income of a minor child is deemed to be that of his or her parent for income tax purposes.

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157 House of Assembly *Debates 1925* 5683. Presumably, the case in question is Income Tax Case 10, which was heard in 1923. However, the case is not named in the House of Assembly Debates.

158 The initial stimulus for tax avoidance schemes involving the making of settlements in favour of minor children was the large increases in tax rates during the First World War (Stopforth1987 *British Tax Review* 417-434). Britain's first attempt to counter these schemes was the introduction of s 20 of the *Finance Act* 1922 (Stopforth1987 *British Tax Review* 417-434).

159 Loutzenhiser *Tiley's Revenue Law* 651.

160 Loutzenhiser *Tiley's Revenue Law* 652.

4 Concluding comments

The phrase *by reason of* is one of the primary determinants of the scope of section 7(3). It indicates that there must be a causal relationship between the income received by the minor child and the DSOD made by the donor parent. In the case of sub-income, the parent's DSOD is one of the factual causes of the sub-income, the other being the decision to invest the income earned in the first instance. Despite differences between income tax and other fields of law, the fundamental problem of causation is universal: the theoretical consequences of an action (such as the making of a DSOD) are limitless and legal responsibility for those consequences must be reasonably, practically and justly confined. The principles of legal causation, as developed in other spheres of law, have and can be applied in an income tax context and in the context of section 7(3) specifically, to prevent the indefinite extension of legal responsibility. It has been argued that applying legal causation principles in this context allows for section 7(3) to be interpreted in a manner that is consistent with its purpose and the broader constitutional values underpinning our legal system.

A grammatical, systematic, teleological and historical reading of section 7(3) does not support a contention that sub-income should, *as a rule*, be excluded from the scope of section 7(3). It has further been argued that the AD's construction of the phrase *by reason of* in *Widan* aligns with contemporary interpretative principles, justifying present-day reliance thereon. In *Widan* the AD ruled that:

> [e]very case must be decided on its own facts and if in any particular case it appears, that apart from proof of any specific intention on the parent of the parent, the effective cause of the income accruing to the minor child was the donation made by the parent, then such income is deemed under section 9(3) to have been received by the parent.[161]

In other words, income (including sub-income) is within the scope of section 7(3) if, based on the facts of the case, the parent's DSOD is the *effective* cause thereof. Based on the AD's use of the terms *effective, efficient* or *proximate* cause in *Widan* it has been suggested that there is no difference between them. The AD in *Widan* also clarified that *proximate* cause is not an absolute term and to construe it as the cause closest to the income in either space or time (as was done in *Kohler*) would be to misunderstand it. A cause that is truly proximate is one that is proximate in efficiency – though there is no general, complete and precise definition of proximate cause.

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161 *Widan* 353.

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List of Abbreviations

AD	Appellate Division
CIR	Commissioner for Inland Revenue
CSARS	Commissioner for the South African Revenue Service
DSOD	donation, settlement or other disposition
ITA	Income Tax Act

ITTOIA 2005	Income Tax (Trading and Other Income) Act, 2005
Loy U Chi LJ	Loyola University Chicago Law Journal
Notre Dame L Rev	Notre Dame Law Review
PELJ	Potchefstroom Electronic Law Journal
S Cal L Rev	Southern California Law Review
SA Merc LJ	South African Mercantile Law Journal
SALJ	South African Law Journal
SAPL	Southern African Public Law
Stell LR	Stellenbosch Law Review
THRHR	Tydskrif vir Hedendaagse Romeins-Hollandse Reg
UK	United Kingdom