Pinetree Resort Pte Ltd v Comptroller of Income Tax
[2000] SGCA 48

Case Number : CA 199/1999

Decision Date : 06 September 2000

Tribunal/Court : Court of Appeal

Coram : Chao Hick Tin JA; L P Thean JA; Yong Pung How CJ

Counsel Name(s) : Stanley Lai and Melissa Koh (Lee & Lee) for the appellants; Foo Hui Min (Inland Revenue Authority of Singapore) for the respondent

Parties : Pinetree Resort Pte Ltd — Comptroller of Income Tax

Courts and Jurisdiction – Appeals – Whether judge was aware of principles governing appeal to Income Tax Board of Review

Revenue Law – Income taxation – Refundable initiation deposits paid as part of fee to join club – Whether initiation deposits are interest-free loans and therefore non-taxable – Whether accounting treatment of deposits conclusive – Whether arrangement a contractual buy-back scheme – Whether payments subject to legal impediments regarded as income – Whether club "received" money – Whether refunds of initiation deposits deductible against income tax – s 10 and s 14(1) Income Tax Act (Cap 134, 1999 Ed)

Bailment – Gratuitous bailment – Mutuum – Whether initiation deposits are mutuum

(delivering the grounds of judgment of the court): ***Introduction***

The appellants are the proprietors of Pinetree Town and Country Club (`the club`), which provides social, recreational and sporting facilities to its members. In order to join the club, a membership has to be purchased, either directly from the club, or from someone who is presently a member through the open market. Where memberships are purchased from the club directly, the potential member is required to pay a fee of which 15% constitutes a `membership fee` and 85% constitutes an `initiation deposit` which is refundable after 30 years. The appellants` tax liabilities in respect of the initiation deposits became the subject-matter of the appeal before us.

The appeal was brought against the decision of Tan Lee Meng J who dismissed the appellants` appeal against the decision of the Income Tax Board of Review upholding the respondent`s refusal to amend two Notices of Assessment which required the appellants to pay $2,115,234 and $122,056.11. These sums were the tax assessed in respect of the initiation deposits for the years 1986 and 1989 respectively. [See [2000] 2 SLR 43.]

Background

The club decided to start the initiation deposit scheme at a Special General Meeting of the members sometime in late 1985. At this meeting, the members of the club decided to increase the maximum number of members from 3,600 to 4,000. The initiation deposit scheme was suggested as a means of marketing the membership. Pursuant to this, the Constitution of the club was amended to require potential members to pay a membership fee, of which 85% constitutes the initiation deposit and 15% constitutes the entrance fee.

Changes were also made to the Constitution to cater for the requirements under which the initiation deposits would be refunded. Under rr 20A and B, the initiation deposit is refundable when an individual or corporate life member (at any time within six months of his having been a member of the club for

30 years) gives written notice to the appellants of his intention to terminate his membership. The appellants would then be required to make the refund, without any interest, of the amount paid as an initiation deposit to the member within 30 days of the receipt of the written notice to terminate membership, provided that all moneys, debts and other liabilities owing to the appellants have been discharged by the member in question. If the appellants do not receive a member`s requisite written notice, then the member will lose his right to the refund of the amount paid as an initiation deposit, but will continue to be a member of the club.

According to the Constitution, the initiation deposit would be forfeited by the appellants in certain circumstances. Rule 19 states that if a member`s payments to the club are in arrears, the initiation deposit may be forfeited at the appellants` discretion and the member`s name removed from the Register of members. When membership is reinstated, the initiation deposit would then be written back as a deferred liability of the appellants. Rule 20 provides that a member will lose his initiation deposit if he resigns from the club. Under r 21, a member who dies, becomes of unsound mind, is adjudicated bankrupt, is the subject of winding up proceedings or is convicted of any offence (other than a traffic accident) would lose his membership and would not be entitled to a refund of the initiation deposit. The initiation deposit would also be forfeited if the club is dissolved under r 26.

The initiation deposits were classified in the appellants` accounts as deferred liabilities. However, the appellants were free to use the initiation deposits and did in fact use them. If the membership was transferred, the initiation deposit would remain as a deferred liability in the appellants` accounts and the appellants` contractual obligation to refund the initiation deposit to the transferee under r 20A was preserved, provided that the other requirements pertaining to a refund were met.

The dispute between the appellants and respondent arose from the respondent`s view that the initiation deposits were taxable as they formed part of the consideration paid by a potential member to join the club. The appellants however felt that, while the entrance fees were taxable income, the initiation deposits were not, as they were interest-free loans from the members of the club and entered as a deferred liability into the club`s accounts. The appellants emphasised that, if and when the initiation deposits were not refunded to the relevant members under the provisions of the Constitution, they would then be subject to tax as they would then accrue to the club as income.

The respondent however assessed tax in the sums of $2,115,234.00 and $122,056.11 for the years of assessment 1986 and 1989 respectively. The appellants appealed against the assessment to the Income Tax Board of Review (`the Board`) who rejected their claims.

The decision below

The main contention in the appeal before Tan Lee Meng J was that the initiation deposits did not accrue to the appellants at the time of payment because they were interest-free loans from the members of the club. This was further evidenced by the possibility that the initiation deposits would have to be refunded to the members under the conditions laid down by the Constitution after 30 years of membership.

The learned judge did not agree with the appellants. He took the view that, due to the numerous conditions that had to be complied with before a member was entitled to the refund of the initiation deposit, as well as the varied circumstances under which the initiation deposit could be forfeited by the club, the initiation deposits were income accruing to the club at the time of payment.

The learned judge added that, in determining the nature of the payments to the club, the issue was

the real character of the payments, and not what the parties called them: **CIR v Wesleyan and General Assurance Society** [1946] 30 TC 11. In so holding, he dismissed the appellants` argument that the Board erred in classifying the initiation deposits as taxable income merely because the appellants had not described the initiation deposits as `loans` in the constitution or in the membership forms. The Board had made it clear that this, viewed in combination with other factors, meant that the clear inference to be drawn was that there had been no intention by either party to the transaction to create a debt. In particular, the learned judge endorsed the Board`s view that the club`s rules, for example, the rule that a member would have to resign his membership in order to get his initiation deposit back, militated against the notion that the initiation deposit was an interest-free loan. Moreover, he noted that the appellants were entitled to a tax deduction for any deposit refunded to a member who made a claim within the prescribed period after the 30th year of membership.

He considered, in contrast, the cases of Raffles Marina Club and Laguna Golf and Country Club, which made similar arrangements with their members, but expressly structured their arrangements and stated from the start that they were taking loans from their members. Due to the fact that these clubs were located on land which is leased to them only for short periods, unlike the appellants, whose club sits on freehold land, the loans made by the members of those clubs were repayable on a fixed date. A trust deed was also made between the two clubs and a trustee corporation which was to act for the benefit of the holders of unsecured notes issued in respect of the loans. The trust deed contained safeguards to ensure that the members would be repaid their loans. As such, the revenue authorities were persuaded that the moneys were not taxable income. These features were not present in the scheme of initiation deposits arranged by the appellants.

Finally, the learned judge rejected the appellants` submission that the initiation deposit should be classified as a mutuum (a quasi-bailment) as there was a real likelihood that the initiation deposit would not be refunded at all. The question of a mutuum thus did not arise and he dismissed the appellants` appeal against the decision of the Board.

The appeal

The appellants raised three main issues in the appeal. Their first contention, that the initiation deposits amounted to loans from the members of the club, encompassed several sub-issues. These included the refund of the initiation deposits, the accounting treatment of the deposits, the nature of the appellants` holding of the deposits, whether the scheme amounted to a contractual buy-back of the membership by the appellants and whether this case was analogous to the scheme of members` loans in Raffles Marina Club and Laguna Golf and Country Club. The second main contention concerned the tax deductability of the deposits which would actually be refunded to members, and the third related to whether the payment of the initiation deposits amount to a mutuum or quasi-bailment.

Preliminary issue: Discretion of the High Court to overturn an appeal from the decision of the Income Tax Board of Review

The appellants submitted as a preliminary issue that the learned judge had erred in suggesting that it is often not easy for a taxpayer to persuade the court to overrule a decision of the Board based on the decision in **Mount Elizabeth (Pte) Ltd v Comptroller of Income Tax** [1986] SLR 421 . They contended that this was only the case where the appeal involved a factual evaluation of evidence. However, as this appeal raised a point of law, viz whether for the purposes of income tax assessment, the initiation deposits constituted loans or mutuums at the point when they were paid by potential

members to the club, the interpretation to be given to the applicable rules of the club, and the inferences made by the learned judge and the Board, an appellate court was in as good a position to evaluate the evidence from which the inferences were drawn.

We did not think that there was much merit in the appellants` submissions on this preliminary issue. In making this statement, the learned judge articulated a well-known test that an appellate body applies in appeals from decisions of the Board. In ***Mount Elizabeth (Pte) Ltd v Comptroller of Income Tax*** , the appellant appealed against the decision of the Board on the basis that the Board was wrong in law and in fact in making certain findings as these findings were made without any or adequate evidence to support them, or if there was evidence, the findings were an inference from primary facts, and as such the appellate court could, in an appropriate case, draw a contrary inference. In dismissing the appellant`s contention on this issue, Chan Sek Keong JC (as he then was) said:

> *In the context of Lord Radcliffe`s speech in* ***Edwards v Bairstow & Harrison*** *[1955] 36 TC 207 and the Court of Appeal`s decision in* ***CBH v Comptroller of Income Tax*** *[1982] 1 MLJ 112 (CA) as to the test an appellate body must apply in hearing an appeal of this nature, the submissions of counsel for the applicant can be distilled and encapsulated into one contention, and that is, the Board erred in law in that no reasonable body of members constituting an Income Tax Review Board could have reached the findings reached by the Board in this instance. When the appellant`s appeal is reduced to this dimension, it becomes apparent that, in this appeal, the appellant has a heavy burden to discharge before achieving lift off. Clearly, the Board had ample evidence before them to make the findings they did. ... I have carefully considered the Board`s decision and the criticisms made against it by counsel for the appellant. In my view, not only was there sufficient evidence for the Board to reach the conclusion they did, there was also other evidence which the Board could have relied upon or drawn inferences therefrom, but did not, to reinforce its conclusion.*

The relevant passage referred to by Chan Sek Keong JC in **Edwards v Bairstow & Harrison** [1956] AC 14[1955] 36 TC 207 in the speech given by Lord Radcliffe at [1956] AC 14, 35-36 states:

> *I think the true position of the court can be shortly stated. If a party to a hearing before the commissioners expresses dissatisfaction with their determination as being erroneous in point of law, it is for them to state a Case, and in the body of it to set out the facts that they have found as well as their determination. ... When the Case comes before the court, it is its duty to examine the determination having regard to its knowledge of the relevant law. If the Case contains anything ex facie which is bad law and which bears on the determination, it is, obviously, erroneous in point of law. But without any such misconception appearing ex facie, it may be that the facts found are such that no person acting judicially and properly instructed as to the relevant law could have come to the determination under appeal. In those circumstances, too, the court must intervene. It has no option but to assume that there has been some misconception of the law, and that this has been responsible for the determination.*

We were of the view that the appellants` criticism of the learned judge`s comments was misconceived. It was apparent from his comments that he did not base his decision on an error in his perceived role as an appellate judge. His reference to the cases above showed that he was well aware of the principles governing appeals to the Board.

Were the initiation deposits interest-free loans?

The crux of the matter in the appeal before us was whether the initiation deposits were interest-free loans made by the members to the club and the appellants. In this respect, the appellants highlighted several issues to show that the learned judge was wrong in approving the Board`s decision that the initiation deposits amounted to income accruing to the appellants.

First, the appellants contended that the judge had placed an inaccurate and incorrect emphasis on the conditions which would have to be complied with before a member could obtain a refund of his initiation deposit. In particular, the judge had considered the clause requiring a member of the club to resign before being entitled to obtain a refund. The judge also noted the circumstances whereby a member of the club would lose his membership and viewed these as forfeitures of the initiation deposits.

The appellants on the other hand argued that the initiation deposits were loans as the club did not receive such deposits free of any persisting legal obligations. The initiation deposits could not be said to have `come home` to the appellants when first paid upon joining the club and had to be free of any persisting obligations before they became taxable. The money collected had to be repaid to the member after 30 years. The reasons behind the creation of this scheme were to finance the borrowing for capital investment in the club and the notion that an overall reduction of the entrance fees (through the subsequent return of the deposits) would make club membership more attractive and marketable. At the same time, the moneys represented by the loan could still be applied by the appellants to the running of the club and the maintenance of its facilities.

The appellants further submitted that a proper interpretation of rr 20A and B in the Constitution, which were freely agreed to by the members of the club, clearly indicated to a reasonable person that the club was under an obligation and liability to return the deposits should members choose to ask for them. The operation of r 20B (which states that a member will cease to be a member of the club after he claims his deposit) did not militate against classifying the initiation deposit as a loan from the member to the club as, if the member chooses not to reclaim the deposit, this would then serve as consideration for continued membership in the club.

Section 10 of the Income Tax Act (Cap 134) provides that income tax is payable upon the income of the appellants accruing in or derived from Singapore. In deciding that this provision was satisfied, the learned judge considered the conditions imposed on the reclaiming of the deposits and the circumstances under which the deposits would be forfeited. He also considered the accounting treatment given to the deposits and compared this scheme to the similar arrangements made by Raffles Marina Club and Laguna National Golf and Country Club.

Now, according to the cases of **Lategan v CIR** [1926] 2 SATC 16 and **CIR v People`s Stores (Walvis Bay) (Pty) Ltd** [1990] 52 SATC 9 (Supreme Court of South Africa), the word `accrue` has been interpreted to mean `to which any person has become entitled`. Although some other cases have ascribed the meaning of `due and payable` to the term `accrue`, we were of the view that entitlement was a more suitable meaning in the context of transactions in this day and age. In any event, the parties did not seriously contest the meaning of the term.

With this in mind, we turned to the substantive arguments raised. The appellants claimed that the initiation deposits were not taxable income at the time they were paid as the payments were not free of persisting legal obligations as they were loans from the members of the club. In support of this, the appellants cited ***C v Commissioner of Taxes*** 46 SATC 57, a Zimbabwean case, and an English case,

Exeter Golf & Country Club v Customs & Excise Commissioners [1980] STC 162. In the former case, the appellant, who carried on a business of fuel-selling and a service station, arranged for a scheme whereby regular customers could opt for a monthly payment for fuel, upon the payment of a deposit. The appellant was not required to return the deposit at a later date, but a customer who terminated the credit arrangement was entitled at any time to demand repayment of the deposit. The Supreme Court of Zimbabwe held that the deposits were loans for consumption and were of a capital nature not attracting tax.

It was noted by Gubbay JA, who delivered the leading judgment, that the appellant`s accountant had testified that, in making the proposal to its customers, the appellant`s intention was that any money so advanced to it would be in the nature of a loan. As such, it was apparent that prior thought had been given to whether the appellant should borrow the sums required from a bank or to raise the cash by way of loans from customers. Furthermore, the learned judge felt that the manner in which the appellant dealt with the moneys provided confirmation of this intention. He said (at p 61):

> *Although deposited into the appellant`s banking account together with the other receipts of the business, the appellant entered a credit into its books of account against the name of each customer in the amount of the deposit payment made, the level of that credit remaining unaltered by the subsequent purchases of fuel from the appellant. ... The deposit payment was not shown as an ongoing credit.*
>
> *These features accord far more with the moneys being treated by the appellant as loans rather than in the nature of payments received in advance for fuel to be supplied. Nor did the customers treat their payments any differently. They regarded the appellant as indebted to them for the full amount of the money provided, which would become due for repayment immediately upon the termination of the credit facility.*

The judge dismissed the arguments raised in support of the tax authorities` position. First, the customers who made the payments did not really do so in order to secure the facility of purchasing fuel on credit, but did it so that the convenient facility of obtaining their fuel on credit would continue to be available. Secondly, although the appellant was not obliged to return the money at a specified future date, a customer who terminated the credit arrangement was entitled at any time to demand repayment of the deposit. Finally, even though there was no liability to pay interest, the customers secured the benefit of not paying any interest in the value of their purchases for fuel for a period of 30 days.

The appellants also relied on ***Exeter Golf & Country Club v Customs & Excise Commissioners*** , which dealt with the question of whether certain payments made by members of a golf and country club to finance the development of the club were exigible to value added tax. These payments were expressed by the club to be interest-free `Members Loans`. These loans were only repayable when a member died, or reached the age of 65 or ceased to be a full member. The commissioners felt that the value of the interest-free loans provided by the members of the club was part of the consideration for the facilities supplied by the company running the club. As such, this amount was taken into consideration when assessing the open market value of the facilities and the value added tax to be imposed. The court held that the loan formed part of the consideration paid by members for the supply of facilities by the club and was part of the open market value of the facilities for the purposes of assessing value added tax. The appellants in the present case said that the decision was useful for the purposes of determining the different types of consideration received by a club. In particular, the appellants argued that in respect of an interest-free loan, the consideration given by

the members of the club lies in the use of the money, not the amount per se. The appellants therefore submitted that the initiation deposits, while amounting as part of the consideration given to the appellants by members of the club for use of the facilities, remained interest-free loans and did not constitute income for the purposes of income tax assessment.

The appellants added that the scheme of initiation deposits was very similar to the arrangements at Raffles Marina Club and Laguna National Golf and Country Club and that the learned judge was wrong to place emphasis on the differences between the schemes operated by the appellants and by the other two clubs. These two clubs took loans from their members which were repayable at a fixed date. The date for repayment was fixed as a consequence of the fact that they were both situated on leasehold land, as compared to the appellants` club, which was situated on freehold land. A trust deed was made between these two clubs and a trustee corporation which agreed to act for the benefit of the holders of unsecured notes issued in respect of the loans. The trust deed contained clauses relating to the ranking of the holders of the unsecured notes vis-Ã -vis holders of secured notes issued by the respective companies as well as stringent safeguards that ensured that members would be repaid their loans.

The problem with the appellants` arguments was that in the two cases cited, as well as the arrangements set up by Raffles Marina Club and Laguna National Golf and Country Club, there was evidence that the moneys paid were intended to be loans to the taxpaying entities. In ***C v Commissioner of Taxes*** , the judge noted the intentions of the appellant that the payments were intended to be loans. This was borne out by the structure of the scheme. As for ***Exeter Golf & Country Club v Customs & Excise Commissioners*** , it was stated at the outset by the club that these were `Members Loans`. There were also many differences between the schemes at Raffles Marina Club and Laguna National Golf and Country Club and at the appellants` club. Apart from the factors mentioned above, we also noted that the members of the other two clubs had up to six years after the fixed date of repayment to reclaim their money, whereas the club`s members had only six months to do so.

The appellants had additionally submitted that the learned judge erred in interpreting the club`s rules to mean that the initiation deposits were unlikely to be paid back to the members. Moreover, the rules had been freely agreed to by the members. In our view these assertions were erroneous and irrelevant respectively. The learned judge had at no time interpreted the rules to mean this. He made it clear that, as long as rr 20A and B were fulfilled, a member could reclaim the initiation deposit after 30 years of membership. The judge also correctly noted that once a claim for the refund was made, a member would lose his membership in the club. Whether the rules were freely agreed to by the members or not was irrelevant to the issue of whether the initiation deposits were taxable at the time of payment. The judge was entitled to look at the rules as factors to determine the character of the initiation deposits. Clearly the court would not rely simply on a labelling exercise to determine whether the payments made were for the purposes of a loan or not, but in all the circumstances of the case and the effect of the rules on the forfeiture (a term used by the appellants themselves in the agreed statement of facts) of the initiation deposits which made the initiation deposits incompatible with the concept of a loan.

Accounting treatment of the initiation deposits

A related issue to the question of whether the initiation deposits were loans from the members was the treatment given to the deposits by the appellants` accountants. The accountants had classified the initiation deposits in the appellants` accounts as deferred liabilities as compared to the entrance fees, which were classified as income. The appellants were free to use the initiation deposits in any

way they pleased. The judge felt that the classification of the initiation deposits was, without more, inconclusive of the matter of whether the initiation deposits were loans.

Both the appellants and respondents highlighted the dictum of Lord Denning MR in **Heather (Inspector of Taxes) v PE Consulting Group Ltd** [1973] Ch 189[1973] 1 All ER 8 where he made the following remark in relation to the evidence of accountants in tax cases. The learned Master of the Rolls said at [1973] Ch 189, 217; [1973] 1 All ER 8, 13:

> *... I have no doubt that the commissioners were influenced considerably by the evidence of a distinguished accountant, Mr Bailey of Messrs Price Waterhouse: ... The commissioners were entitled to give weight to that evidence of Mr Bailey, but the judge went further. He seems to have thought that, as a result of the decision of this court in* ***Odeon Associated Theatres Ltd v Jones (Inspector of Taxes)*** *the evidence of accountants should be treated as conclusive and that all the commissioners or the court would have to do would be to evaluate their evidence. And counsel for the taxpayer company submitted to us that the* ***Odeon*** *case had upgraded the evidence of accountants so that the commissioners and the courts were bound by their evidence to a greater degree than they had been in the past. I cannot agree with that for a moment. It seems to me that that case does not add to or detract from the value of accountancy evidence. The courts have always been assisted greatly by the evidence of accountants. Their practice should be given due weight; but the courts have never regarded themselves as being bound by it. It would be wrong to do so. The question of what is capital and what is revenue is a question of law for the courts. They are not to be deflected from their true course by the evidence of accountants, however eminent.*

On the basis of the general principle set out above, both the learned judge and the respondents took the view that the courts are not bound by the evidence of accountants.

The appellants pointed out, however, that in ***Heather (Inspector of Taxes) v PE Consulting Group Ltd*** , the issue was whether to accept accounting evidence for the purpose of deciding whether a particular entry should be classified as capital or revenue. In other situations, the appellants submitted that the courts have placed considerable weight on the practice of accountants in so far as they do not conflict with any positive rule of law. Where there is only one treatment by the accountants, this should be given due weight and should not be disregarded in the absence of any positive rule of tax law or accountancy to the contrary. As such, they said that the principle in ***Heather (Inspector of Taxes) v PE Consulting Group Ltd*** was not applicable to the present case.

We disagreed with the appellants` view of the matter. The editors of ***Whiteman on Income Tax*** (3rd Ed) point out that in general, if accounts are prepared in a normal commercial manner and in accordance with current accountancy practice, the profit shown by those accounts will be taken as the taxable profit, subject to any specific statutory provisions and to ***the overriding power of the court to disregard accountancy practice where that practice appears to be based on a mistaken view of the law*** . This spells out the fact that regardless of how persuasive accounting evidence is, the prerogative still lies with the court to decide whether a particular item should be regarded as income that has accrued for the purposes of liability to tax. Lord Denning`s dictum in ***Heather (Inspector of Taxes) v PE Consulting Group Ltd*** was a particular instance where accountancy evidence was of even more limited relevance in determining whether receipts or expenditure were of a capital or revenue nature. However, this does not detract from the general principle that a court has an overriding power to form its own conclusions. This is so particularly when the issue at hand has been accepted by the appellants to be a question of law as the facts are not in

dispute. The court is entitled to look at the undisputed facts, most of which have been dealt with above, and then make a decision as to the character of the initiation deposits at the time of payment. The evidence of the accountants, while relevant, is not overwhelmingly persuasive, as the appellants have strenuously argued.

Finally, the appellants` argument, based on **Minister of National Revenue v Anaconda American Brass Ltd** [1956] AC 85, that the court only has a choice where there are two alternative accounting methods and it has to choose between the two, is misconceived. It does not make sense for the courts to be free to disregard an accounting method only when there are two alternatives. These cases in fact exemplify the basic principle that the court ultimately makes the decision, according to statute, as to whether certain expenditures or receipts are taxable or not. The learned judge was thus not wrong in choosing not to treat the accounting treatment of the initiation deposits as conclusive.

Would the eventual refund of the initiation deposit amount to a contractual buy-back of the club membership?

We now turn to the appellants` objection to the judge inferring that the arrangement amounted to a contractual buy-back by the appellants of the memberships in the club. This inference had been drawn from the fact that a member who claimed his refund of the initiation deposit would have to terminate his membership in the club.

The appellants argued that this reasoning was faulty and referred to two decisions of the Indian Supreme Court. The first was **Punjab Distilling Industries Ltd v CIT Simla** [1959] 35 ITR 519. In this case, the taxpayer sold liquor to wholesalers. The taxpayer charged a security deposit over and above the price of bottles. The taxpayer was legally obliged to refund these security deposits when 90% of the bottles covered by them were returned. These deposits were held by the assessee in its general ledger under the term `empty bottles return security deposit`. The court held that these sums were income-assessable although they were refundable, as the sums were considered to be an extra price for the sale of liquor and the wholesalers were not under any obligation to actually return the bottles.

As for **Lakshmanier & Sons v CIT, Madras** [1953] ITR 202, the taxpayer, who ran a business selling yarn, arranged for his customers to pay a certain sum which was kept in deposit once and for all before he commenced business with them. The deposited moneys were to be refunded at 3% per annum at the conclusion of the business between the parties, subject to a retention, where necessary, of any amount due on contracts that remained unpaid at the termination of business. These deposits were held to be loans and were not exigible to tax. This was due to the fact that the amount deposited by a customer did not bear any relation to the price fixed for the goods to be delivered under a forward contract, unlike previous practice. There was no adjustment out of the deposit in respect of the contract price. Instead, the deposit was held by the appellants as security for the due performance of the contracts by the customer so long as his dealings with the appellants by way of forward contracts continued. It was only at the conclusion of the `business connection` that an adjustment was to be made towards any possible liability arising out of the customer`s default. Apart from any such contingency, the appellants there undertook to repay an equivalent amount at the termination of the dealings. The deposits thus had all the essential elements of a contract of loan.

Neither of the two cases was directly analogous to the facts of the case before us. However, they were useful aids in determining whether certain sums of money, when paid, constitute part of the

consideration in relation to a contract for sale of certain items, or are a separate type of transaction, such as a loan. We did not agree with the appellants that the facts of this case were akin to the situation in ***Lakshmanier & Sons v CIT, Madras*** . In truth, the arrangements for deposits to be made in that case were additional to the transactions between the parties and the court was therefore able to find that the deposits there amounted to loans. In the present case, however, the initiation deposits formed part of the sum of money paid over by a potential member in consideration of his obtaining membership at the club. This brought the transaction more in line with the situation in ***Punjab Distilling Industries Ltd v CIT Simla*** where a refundable sum of money which was charged over and above the price of bottles of liquor was regarded by the courts as trading receipts.

The appellants attempted to distinguish ***Punjab Distilling Industries Ltd v CIT Simla*** by saying that the taxpayer in that case was claiming immunity from being taxed at all on the credit balances which were unclaimed, whereas the appellants would not be carrying any such unclaimed balances or trading receipts of an income nature, and in fact were willing to pay tax on any unclaimed initiation deposits once the time frame for the refunds had passed. However, we noted that the customers in ***Punjab Distilling Industries Ltd v CIT Simla*** were still entitled to claim their refunds from the taxpayer if the conditions were fulfilled, much like the members of the club in this case. The important question was the way in which the taxpaying company treated the moneys received which, in the absence of the express intentions of the parties, provided an indication of what the nature of these payments were.

We were also referred to two other `bottle and tin` cases. In **Brookes Lemos v CIR** [1947] 14 SATC 295, the taxpayer sold fruit squashes and other foodstuffs in glass containers. Its customers paid a deposit for each container, subject to an undertaking that, if a similar container was returned by the customer, the amount of the deposit would be returned. There was no obligation on the part of the customer to return the containers. The amounts received as deposits were credited to a separate account but were not held as trust moneys and were utilised for the general purposes of the business. The Supreme Court of South Africa held that these deposits were part of the gross income of the taxpayer.

This was likewise the case in **Greases (SA) Ltd v CIR** [1951] 17 SATC 358 which concerned drums in which grease was supplied to the taxpayer`s customers. Again, the deposits for the drums, which were refundable in the event that the drums were returned, were held to be included in the gross income of the taxpayer even though these sums were never regarded as being sales revenue. The Chief Justice of South Africa commented that the dominant fact in that case was that, although the taxpayer kept the money in a separate account, it received the deposits for its own benefit in that it was entitled to use the deposits in its business and the moneys were not deposited in any trust account.

The conclusion of the Board and the learned judge that the arrangement amounted to a contractual buy-back of the membership was therefore not as far-fetched as the appellants made it out to be in the light of the cases above, in which case the initiation deposits would be subject to tax.

It would also be appropriate at this point to consider the appellants` argument that the initiation deposits should not be regarded as having accrued to the appellants as these payments were subject to legal impediments. They cited the case of ***Arthur Murray (NSW) Pty Ltd v FCT*** 14 ATD 98 in support of this proposition. This case held that fees received in advance for dancing lessons were not exigible to tax and only formed part of the taxpayer`s income as and when they were earned by the actual giving of the lessons. Tan J distinguished this case in the court below saying that the case concerned advance payments, which was unlike the circumstances in the present situation. In our view, even where payments are subject to legal impediments, the cases above show that this factor is not conclusive of whether the payments could be regarded as income. The courts clearly take into

account other factors, in particular, how the taxpaying companies deal with the moneys, in deciding this matter. ***Arthur Murray (NSW) Pty Ltd v FCT*** was thus not very helpful to the appellants` case.

Nature of the appellants` holding of the moneys

A final side issue to the main question of whether the initiation deposits accrued to the appellants at the time of payment was whether the property in the moneys passed to the appellants then, and how these moneys were treated. The appellants cited the cases of **Jay`s the Jewellers Ltd v IRC** [1947] 2 All ER 762 and **Morley v Tattersall** [1938] 3 All ER 296 to support their argument that they had not `received` the moneys in a true sense of the word as the members were free to reclaim them.

Again, the present facts were not akin to the two cases above. In ***Jay`s the Jewellers Ltd v IRC*** , the taxpayers were pawnbrokers. The case concerned the proceeds of sale from the items left with them. These proceeds of sale were not the property of the pawnbrokers and remained the property of the debtors who were given three to six years to reclaim the sums. It was only after this had taken place that the moneys became the property of the pawnbrokers. As for ***Morley v Tattersall*** , the sums which were the subject of income tax assessment were never regarded as being the property of the taxpayers who had an unqualified obligation to repay the sums when the owners of the moneys showed up. As such, the cases were not relevant to the present case as the appellants had been at liberty to use the moneys representing the initiation deposits as they pleased.

Would refunds of the initiation deposits be deductible in relation to the appellants` future income tax assessments?

In the court below and before the Board, the appellants were not comforted by the respondent`s assurances that, if initiation deposits were refunded to members in the future, these would be deductible under s 14(1) of the Income Tax Act against the appellants` incomes in the years when the refunds would be made. The appellants argued that, if the initiation deposits were regarded as income accruing at the point of payment, then s 14(1) would preclude a deduction in the event of a refund since such a refund would amount to a make over of income as the Income Tax Act does not allow deductions that are in the nature of income refunded given that the refunds cannot be said to be an expense to which s 14(1) applies. The appellants cited in support of this proposition, **Port Elizabeth Tramway Co Ltd v CIR** [1935] 8 SATC 13. Apart from this, the appellants also submitted that they would be out of time in bringing a claim for repayment of tax by virtue of s 93(2) of the Income Tax Act which limits such claims to within six years from the year of assessment to which the claim relates.

Section 14(1) of the Income Tax Act provides that in ascertaining the income of a taxpayer for any period, there shall be deducted all outgoings and expenses wholly and exclusively incurred during that period by the taxpayer in the production of the income as long as these are not expressly prohibited by other sections in the Income Tax Act. The important feature of when deductions may be made for the purposes of this case is the fact that s 14 requires a nexus between the incurrence of the expense and the production of income. In determining whether this nexus is present, the business has to be looked at as a whole set of operations directed toward producing income, in which case an expenditure which is not capital expenditure is usually considered as having been incurred in gaining or producing income; **W Nevill & Co v FCT** [1937] 56 CLR 290.

As we had adjudged that the initiation deposits were not loans, their refund would likewise not amount to repayments of loans. The refunds of the deposits would not be said to be expenditure

relating to the acquisition of a source of income or a capital asset and would hence not be of a capital nature. In this respect, it was difficult to understand why the appellants did not think that the refunds would not be deductible as outgoings and expenses incurred in the production of profits by the appellants. The respondent had pointed out that, if one were to look at the refunds as contractual buy-backs of the club membership, these would amount to expenditure incurred as a necessary incident of running the club and generating income.

The appellants` reliance on ***Port Elizabeth Tramway Co Ltd v CIR*** to show that the refunds would not be deductible as they amount to expenditure payable out of income after it has been earned, such as a tax on profits, was misplaced. The term `payable out of income` was intended as a reference to expenditure such as tax on profits. The refund of the initiation deposits would not be in the same category as tax on profits. As stated above, they could be characterised as contractual buy-backs of the memberships, in which case, they would amount to expenditure incurred for the purpose of producing the income generated from selling club memberships.

In view of this, there was little merit in the appellants` contentions that it was legally impossible for the respondent to deduct refunds of initiation deposits against the appellants` income tax for the year in which the refunds are made. As pointed out by the respondent, it is settled law in many jurisdictions that it is not necessary, in order to render an expense deductible, that the expense in question should produce assessable income in the same year in which the expenditure is incurred. Moreover, the respondent had implicitly acknowledged that the refunds would be deductible in the event that the appellants have to pay this out in the future. The appellants` concern that s 93(2) of the Income Tax Act would prevent them from claiming the deduction was also unfounded. Section 93 deals with the payment of excess income tax by a person and claims related to it. This was not the case here. The appellants would only be claiming a deduction off their tax bill in the event that they had to refund the initiation deposits, not a refund of overpaid income tax.

In any event, we were inclined towards the view that whether the appellants were able to mount a successful claim for a refund or not was not entirely relevant to the issue that faced us in this case of whether the court regarded the initiation deposits as income that had accrued at the time of payment or not. It would fall to the appellants to sort out the matter of deducting the refunds as expenses if and when they arise in the future. Simply because they might be unsuccessful in doing so could not work in their favour in relation to the matter before us. The appellants` arguments in relation to either being over-taxed or not being able to claim a deduction of the refunds made were therefore unwarranted.

Mutuum

The appellants` final contention was that the initiation deposits constituted a mutuum, or a gratuitous quasi-bailment of moneys between the members of the club and the appellants. Despite the appellants` strenuous efforts to emphasise that a mutuum is not a type of loan, ***Jowitt`s Dictionary of English Law*** , Vol 2 (2nd Ed) states that it is:

> *... a loan whereby the absolute property in the thing lent passes to the borrower, it being for consumption, and he being bound to restore, not the same thing, but other things of the same kind. Thus, if corn, wine, money or any other thing which is not intended to be returned, but only an equivalent in kind, is lost or destroyed by accident, it is equivalent in kind, the maxim* ***ejus est periculum cujus est dominium*** *applying to such cases. In a mutuum the property passes immediately from the mutuant or lender to the mutuary or borrower, and the identical thing lent cannot be recovered or redemanded.*

The appellants relied on **Parastatisdis v Kotardis** [1978] VR 449 in which it was argued that a loan between the parties was a mutuum. The lendor had executed a document agreeing not to recall the loan within a two-year period. However he subsequently decided to do so. The borrower contended that the fact that the loan was a mutuum meant that it was capable of generating enforceable promissory obligations as to the period of the borrower`s enjoyment of the loan moneys, irrespective of the absence of consideration for that promise not to recall the loan within two years. The court in that case felt that, as the bailment arose from a contract, the bailment relationship should be governed in accordance with the contract. As there was no consideration for the lendor`s promise not to recall the loan for two years, the lendor was entitled to recall it at any time.

In our judgment, the appellants could not successfully classify the initiation deposits as a genus of mutuum. A mutuum is a type of loan, even though it is also regarded as a quasi-bailment. The initiation deposits were not loans for the reasons we have stated above. In this respect, ***Parastatisdis v Kotardis*** was inapplicable to the matter before us.

Conclusion

In the premises, we dismissed the appeal with costs.

Outcome:

Appeal dismissed.