Debtors on yearend – tax saving opportunity

By Johan Kotze

Taxpayers most often regard their debtors on yearend merely to be amounts subject to tax.

Debtors are recognized in a person financial accountings system because the person may be expecting some sort of payment. The auditors then recognized debtor when significant risks and rewards of ownership are transferred to the buyer.

The accountants look at a debtor from an economic perspective, whereby the Income Tax Act is a law and driven by judicial pronunciations.

The definition of 'gross income' in the Income Tax Act provides that income is taxable in the year of assessment in which it is 'received by' or 'accrues to' the taxpayer, whichever occurs first.

A debtor can therefore only be taxed in the same year if it also accrues to the taxpayer in that year. It is now *trite* that a debtor will only accrue for tax purposes if the person has become entitled to the amount in question. A contingent or conditional right does not give rise to an entitlement of a debt.

In the past many cases dealt with the query of what is meant by 'accrual' and one would think that the topic must have been exhausted by now – well, not so.

In a recent case in the Johannesburg's Tax Court (Case No. 12262, in front of Judge Willis, held at the very nice, new Megawatt Tax Court facility) the issue was whether

certain transactions for the sale of fluorspar, which the taxpayer had dispatched to customers overseas, had accrued in the year of dispatch or in the following year in which payment was received.

The case went further, and alternatively, if the amount only accrues when payment is received in the following year, how much of the expenditure in respect of acquisition of the fluorspar should be added back in terms of section 23F(2) of the Income Tax Act.

The main witness for the taxpayer, being an engineer by training and profession (and according Judge Willis has more degrees than a *thermometer*) testified that the fluorspar is sold under strict requirements. The main requirement is that the fluorspar should contain at least 97% calcium fluoride. The delivery of the fluorspar is subject to inspection and analysis of independent assayists and if the fluorspar does not comply with the specifications the whole shipment can be rejected.

It was common cause that the fluorspar was shipped in terms of FOB (Free on Board) contracts, and to SARS this was the determining factor.

Judge Willis held that fluorspar is a *fungible* product, i.e. a product that is sold by number, weight or measure. The sale of fluorspar was in each instance not yet perfected on yearend (*venditio imperfect*), because there was no certain price (*certum pretium*) until the assayist in the country of destination had confirmed that the delivery met the purchaser's specifications.

The fact that these goods were shipped FOB did not change matters either.

Ordinarily, where goods have been shipped in terms of FOB contracts, ownership of the goods passes upon the handover of a bill of lading to the purchaser, but where

the purchaser could refuse to accept the goods upon inspection this general rule does not apply.

It does not necessarily follow from the fact that if a contract is FOB that once the cargo is 'on board' the seller has acquired the right to claim payment from the purchaser. There must be a mutual intention that ownership should pass upon loading on the ship.

In this instance, the mutual intention between the seller and the purchaser as to the event, which triggers the passing of rights and obligations when goods are to be in transit, is of critical importance.

The judge therefore held that the accrual only took place in the year in which the taxpayer got paid.

The question then was how much and which costs should be added back, in terms of section 23F(2), in the year in which the fluorspar was dispatched, only to be allowed as a deduction in the following year. The only costs to be added back were the 'expenditure incurred in respect of the acquisition' the fluorspar.

The taxpayer incurred royalties, mining costs, processing costs, and dispatch costs.

Judge Willis held that only the mining costs and processing costs fell within the ambit of 'expenditure incurred in respect of the acquisition'. The royalties were conceded by the taxpayer, whereas the parties accepted that the dispatch costs were not in respect of the acquisition.

Taxpayers should therefore consider whether their debtors on yearend accrue for tax purposes and this is dependent on the terms of the relevant agreement. It is worth

analyzing one's debtors on yearend, because it can lead to a fair amount of tax being saved in that year of assessment.

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