

Recoupments, Accounting Practice, and Income-Tax Principles

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1 Introduction

It is generally accepted that the Income Tax Act 58 of 1962 requires that a person's taxable income be determined in terms of a statutory formula, the basic elements of which are the defined concept 'gross income' (s 1 sv 'gross income'), the permitted exemptions, and the general deduction formula, as well as the specific deductions permitted for purposes of arriving at a person's taxable income (see, for example, D Meyerowitz *Meyerowitz on Income Tax* (2002–2003) 5.7–5.10; *Silke on South African Income Tax* memorial ed by A de Koker (1995) 1.11–11.14). Since *CIR v George Forest Timber Co Ltd* 1924 AD 516 at 522 and 528 our courts have stressed the artificiality of this statutory formula. A court must, as a point of departure, concern itself not with accounting entries in a taxpayer's books of account, or with accounting principles and practice, but with the provisions of the Act: 'What has to be ascertained is the "taxable income", and this has to be ascertained in the manner prescribed by the Act and in no other' (*Pyott Ltd v CIR* 1945 AD 128 at 135–136).

Parliament recently adopted the same approach to the determination of the amount of a person's 'taxable capital gain' (para 10 of the Eighth Schedule) that is to be included in that person's taxable income for a tax year (s 26A): it should be determined according to a prescribed scheme that embodies various defined concepts, and not with reference to accounting principles.

So accounting principles can be taken into account when a person's taxable income is determined only if and to the extent to which such principles are recognized by the Act (for example, s 24K(2) regarding the time of incurral or accrual of amounts in respect of interest rate agreements). So I was rather taken aback by the recent judgment of the Supreme Court of Appeal in *Omnia Fertilizer Ltd v CSARS* (2003) 65 SATC 159 regarding the tax consequences of certain accounting entries by the taxpayer. The court's stance in this case poses the important question as to whether an accounting principle not specifically embodied in the Act can be reconciled with the current statutory scheme for the determination of a person's taxable income (including any taxable capital gain).

2 The Approach in *Omnia Fertilizer*

In *Omnia Fertilizer*, the taxpayer claimed the purchase price of raw materials bought on credit and the cost of transporting them to its factory

as part of its deductible expenditure incurred in the production of its income. The amount of such expenditure was calculated by it upon receipt of the required materials but before receipt of the relevant invoices. Appropriate accounting entries were made in its books by debiting an expenditure account. No payments were made to suppliers in respect of any uninvoiced goods, as they were credited in O's books only on receipt of invoices from them. Some of the suppliers concerned later failed to invoice O for the supply or transport of the materials. O's experience regarding the regularity of these failures enabled it to determine a stage at which it could be assumed that an invoice would in all probability not be received. It accordingly credited half of the unclaimed amounts to its income account after one year, and the other half after two years. The amounts written back to its income account had not prescribed at the time and so were still subject to O's legal liability to pay the suppliers had they demanded payment. But there was never an instance of a creditor later demanding payment of an amount written back to income (see at 161–162, 162G–H and 164A–C).

The Commissioner treated the sums written back for accounting purposes to O's income account as amounts recovered or recouped in terms of section 8(4)(a), and accordingly included them in O's gross income for the tax years during which they were so written back.

O appealed to the Income Tax Special Court (now referred to as the tax court) (see *ITC 1722* (2002) 64 SATC 105). It argued that the creditors' failure to claim payment of the debts had not resulted in any receipt by or accrual to O, and that there had accordingly been no recoupment of any amount. Goldblatt J, however, expressed the view (at 107I) that section 8(4)(a) requires the amount of any expense allowed as a deduction and later recouped to be included in a taxpayer's income, even if it does not otherwise amount to income. An unpaid expense, in his view, is recouped if it is no longer likely to be claimed and there is no real need to provide for such a claim. He referred (at 108C–E) to similar conclusions by Conradie J (*ITC 1704* (2001) 63 SATC 258 at 263D) in respect of a liability that ceases to burden a business, and Wunsh J (*ITC 1634* (1998) 60 SATC 235 at 258) in respect of a liability that is cancelled or reduced. The argument that O's creditors might still claim the monies owing to them and that there had thus been no recoupment of those expenses was also rejected (at 108H–J): '... [O], who is the best judge, has decided that it can safely treat the debts as unclaimable and therefore distribute the amounts not claimed as profits. [O's] own accounting system, as opposed to any invoices issued, identified the amount of expenses incurred and similarly identified expenses which would not be claimed ie which were recouped.' Goldblatt J referred, finally, to the similar conclusion reached by Wunsh J (*ITC 1634* supra at 259) on broadly similar facts and dismissed O's appeal.

The issue in the appeal to the Supreme Court of Appeal was whether

O's accounting treatment of these amounts constituted their recovery or recoupment for purposes of section 8(4)(a); put differently, whether an amount still owed to a creditor can be recouped for tax purposes. The argument on behalf of O ran along these lines (see at 162B–C and F–I, and 164H–I): a recoupment cannot depend solely on the actions or subjective decisions of an individual taxpayer. The principle, on a proper interpretation of the Act, is similar to that which applies to accruals (the Act requires positive proof from a taxpayer that the amount accrued will not be paid to it). What is required for the recoupment of an expense is proof that a taxpayer will never actually have to pay it. There cannot be a recoupment merely by reason of the taxpayer's expectation that it will probably never be called upon to pay a debt where the legal liability giving rise to an allowable deduction still exists. The insertion in the Act, in 1997, of section 8(4)(m) (in terms of which a taxpayer who is relieved from the obligation to pay an expense in respect of which a deduction has been allowed, is deemed to have recovered or recouped the amount of it (see 3.2.5 below)) indicated that Parliament had always intended a recoupment as necessarily involving the extinction of a liability. So O's mere accounting treatment of the amounts still owed by it at the end of the tax years in issue did not render them receipts, accruals, recoveries, or recoupments in respect of those years within the meaning of the Act.

In a unanimous judgment delivered by Howie P, the court rejected these arguments. His reasoning (at 162ff) can be summarized thus: Parliament linked taxability to the recovery or recoupment of an amount allowed as a deduction. 'Recoup' carries a very wide meaning, and nothing in section 8(4)(a) or its context signifies that it should bear any narrower meaning. Release from indebtedness is not part of the ordinary meaning of 'recovered' or 'recouped'. The insertion of section 8(4)(m) in 1997 also signifies that the termination of legal liability is not a requirement for recoupment. Had Parliament intended that an amount allowed as a deduction would become taxable as a recoupment only if legal liability for payment ceased to exist by way of prescription or otherwise, it could have said so. The crucial enquiry is not whether a debt has for some or other reason ceased to exist — a debt also ceases to exist on payment, not only when it prescribes. If it does cease to exist before payment occurs, even then there may not be a recoupment until the taxpayer takes some or other step to recoup. In the case of an unpaid amount allowed as a deduction, there is 'an assertion by the taxpayer, accepted and acted upon by the Commissioner, recognizing the likelihood, if not the inevitability, that the debt will be paid' (at 163G–H). Parliament wished to ensure that a taxpayer should not escape taxation 'if alleged expenditure was not to be expenditure after all, whether or not liability was legally terminated' (at 163A–B). If the taxpayer erases the debt from its books and treats the amount of it as available for another purpose, the crucial enquiry is whether that amount

has, ‘for all practical purposes, reverted to the taxpayer’s “pocket”’ (at 163H–J).

It was clear, in the court’s view, that O had regarded itself as at liberty to deal with the amounts that would probably not be actual expenditure after all as unexpended and had for that reason credited them to income. Howie P concluded (at 164C–D):

‘As such, they were available for a purpose other than that for which the tax deduction had originally been allowed. In plain terms the amounts reverted to the taxpayer’s pocket. In my view . . . the taxpayer recouped these amounts.’

After referring with approval to the similar approach adopted by the Special Court in *ITC 1634* (supra at 259) and the perceived approval of it in *ITC 1704* (supra at 262), Howie P continued (at 164G): ‘Furthermore, assuming that the relevant entries did not in themselves effect recoupment the facts nonetheless compel the conclusion that the writing back to income constituted an admission by the taxpayer that the amounts had been recouped, by which admission, in the absence of any consideration depriving it of binding effect, the taxpayer must be bound.’

So O suffered the same fate as in the Special Court.

What is striking, when reading the judgments by the Special Court and the Supreme Court of Appeal, is the extent to which they are based on reasoning similar to that adopted by Wunsh J in *ITC 1634* on similar facts. Both Goldblatt J and Howie P referred with approval to the conclusion by Wunsh J (at 259) that ‘[b]y recognizing that, for all practical purposes, the unpaid liabilities [that had not yet prescribed] had ceased to exist as such, by reason of the ineptitude of the creditors, in particular by transferring the amounts to its profit account and ceasing not only to reflect the whilom creditor as one but even to hold the amounts in suspense, the appellant took the unclaimed and unpaid amounts as accruals, or procured a recoupment of its expenditure’.

Conradie J (*ITC 1704* supra at 261C–D) also assumed that the treatment of prescribed debts in the taxpayer’s books of account had the effect of extinguishing them. But it is unclear to what extent he relied on or supported the reasoning of Wunsh J — Conradie J merely quoted, without comment, the views expressed by Wunsh J (at 257 and 259) that the appellant’s conduct justified the recognition of the amounts transferred to profits as income. *ITC 1704* can be distinguished from *ITC 1634* not only on the facts (the debts in the former case had prescribed) but also for Conradie J’s acceptance (at 263G–H) of the principle that a taxpayer cannot change his fiscal liability merely by the manner in which he keeps his internal accounts.

3 An Evaluation of the Approach

3.1 Australian Case Law

Wunsh J appears to have based his reasoning on principles enunciated in Australian case law (see at 256 and 258). The Australian cases analysed by him (at 247–257) and cited in support of his approach deal with the fiscal effect of a subsequent variation of a liability. These cases deal mainly with gains and losses from exchange rate fluctuations (for example, see *Texas (Australasia) Ltd v CoT (Commonwealth)* (1944) 2 AITR 4, *International Nickel Australia Ltd v FCT* (1978) 7 ATR 739, and *Avco Financial Services Ltd v FCT* (1983) 13 ATR 63), the redemption of debentures at a discount (*Mutual Acceptance Ltd v FCT* (1985) 15 ATR 1238), and the estimation of the liability of a short-term insurer to insured clients (*RACV Insurance Pty Ltd v FCT* (1975) 4 ATR 610). The question is not whether the Australian principles are similar to those embedded in the Act (for a discussion of the Australian principles, see Henry Vorster ‘Unquantified and Defeasible Expenses Incurred in the Production of Income’ (1985) 1 *SATJ* 1 at 2–8 and 12) but whether these principles are relevant to the issue before the court. The Australian principles governing the treatment of recoveries, recoupments, and compromise benefits differ, as noted by Wunsh J (at 258), from those of the Act — there is no general recoupment provision similar to that in section 8(4)(a) (see also the remark at 259 regarding *CoT v Rowe* (supra)). The Australian principles referred to provide no real guidance as to the interpretation of the scope of the recoupment provision. Moreover (as Wunsh J acknowledged at 257), these Australian cases all deal ‘with a legal event which has resulted in the reduction of a liability’, while ‘there was no such external event’ in the form of a variation of the taxpayer’s liability to a creditor, or any ‘express or implied forgiveness of any debt by a creditor’ in the case before the court. It is not surprising that Howie P (at 164E–F) considered it unnecessary to determine whether the Australian cases provided any support for Wunsh J’s reasoning: the issue before the Australian courts was actually irrelevant to the issue decided by Wunsh J and Howie P — whether the treatment, for accounting purposes, of a debt as having ceased to exist in fact although it was still legally owed to the creditor, constituted a recoupment for purposes of section 8(4)(a). The approach of Wunsh J and Howie P is based on the recognition, for purposes of this provision, of accounting principles. The real issue is whether their approach accords with the principles to be extracted from the Act.

3.2 The Scope of the General Recoupment Provision

3.2.1 The Underlying Function of the General Recoupment Provision

A general recoupment provision providing for the inclusion in a taxpayer’s income of a wide range of deductions and allowances once

they have been recovered or recouped, was introduced for the first time in 1941 (s 11(4)(a) of the Income Tax Act 31 of 1941). The previous consolidation act provided for the recovery or recoupment of specific expenses only, such as certain mining expenses (s 7(1)(f) of the Income Tax Act 40 of 1925).

The main elements of the general recoupment provision have not changed substantially since 1943 (provision was then made for the recoupment of amounts allowed to be deducted or set off 'whether in the current or any previous year . . . which have been recovered or recouped during the current year' (see s 11(4) as substituted by s 5(c) of the Income Tax Act 26 of 1943). The words 'recover' or 'recoup' carry, as noted by Howie P (at 163B–C and E–F), a very wide meaning (see also *Moorreesburg Produce Company Ltd v CIR* (1946) 13 SATC 245 at 252). But the meaning of 'recoup' can be determined only by considering the Act as a whole; put differently, the meaning and function of the general recoupment provision has to be determined within the context of the Act (see *Grootvlei Proprietary Mines Ltd v CIR* 1952 (4) SA 440 (A) at 446G–H).

By requiring the inclusion, in a taxpayer's income, of an amount allowed as a deduction or allowance that is later recovered or recouped, the general recoupment provision effectively neutralizes that deduction, and so denies the taxpayer the benefit of that deduction or allowance. Also, the Act prohibits the deduction of an expense or loss that is recoverable under any contract of insurance, guarantee, security, or indemnity (s 23(c)). De Koker (Silke op cit 7.10) states that the purpose and scope of this prohibition, and its interaction with the recoupment provision, are unclear (see also the editorial note 'Section 23(c) — an Anachronism' (1985) 24 *ITR* 318). To my mind, this is the position: a taxpayer who has an unconditional contractual right, as at the date of incurral of an expense or loss, to recover it from another person in terms of a contract of insurance, guarantee, security, or indemnity, cannot deduct that expense or loss. So the corresponding benefit to which the taxpayer is entitled at the time of the incurral of the expense or loss must be brought into account to determine whether any deduction can be claimed in respect of that expense or loss. There is no question, therefore, of the recoupment of that expense or loss upon its ultimate recovery (Meyerowitz op cit 11.12). The recoupment provision, by contrast, applies where a taxpayer becomes entitled, after the incurral of an expense or loss, to recover or recoup it, whether such entitlement arises during the year of incurral or in a later tax year. The function and scope of section 8(4)(a) becomes clear if it is read in conjunction with the prohibition in section 23(c). Denying a deduction to a person with a prior entitlement to be recompensed for an expense and neutralizing a deduction in respect of an expense that is later recovered or recouped have one feature in common — they allow the deduction of an expense or loss, for tax purposes, only if the person who incurred that expense or

loss ultimately bears it. This principle is, as I have argued elsewhere (‘The Taxation of Trusts — Superimposing New Rules on Old Principles’ 2002 *Acta Juridica* 102 at 109), the mirror image of the principle that an amount is recognized as an accrual in the hands of a person if it is an accrual for that person’s benefit.

So the question, to determine whether an expense or loss has been recouped, is whether an event has occurred as a result of which the person in whose hands that expense or loss has been recognized, is entitled to be recompensed for it, or has been relieved from actually bearing it. The nature of this event is determined by the requirements for the recognition of an accrual or expense.

3.2.2 The Recognition of Unconditional Rights and Obligations

A person’s taxable income is, as I have noted, determined in terms of a statutory formula, the point of departure of which is ‘gross income’ (s 1). An amount can, generally, form part of a person’s gross income for a specific tax year only if it is received by or accrues to that person during that tax year (see the introduction to the definition of ‘gross income’ in s 1). An amount accrues to a person as soon as that person acquires an unconditional right or entitlement with a money value, even if the amount is payable only in a later tax year (*Lategan v CIR* 1926 CPD 203 at 209, as confirmed in *CIR v People’s Stores (Walvis Bay) (Pty) Ltd* 1990 (2) SA 353 (A) at 363–365). The amount must, in principle, be determined as at the date on which the unconditional right is acquired, without any regard to the debtor’s ability as at that time to pay such amount, or to the likelihood that it may never be paid (see *CIR v Delfos* 1933 AD 242 at 260–261). An accrual that forms part of a person’s gross income is reflected at its face value (see the proviso to the definition of ‘gross income’ in s 1). The likelihood of the eventual recovery of that amount may be taken into account only if, and to the extent to which, the Act makes specific provision for it, such as in terms of the bad debt allowance (s 11(i)), or the doubtful debt allowance (s 11(j)). The amount of a bad debt can, according to the wording of section 11(i), be claimed as a bad debt even in the same tax year in which that debt has been reflected as part of the taxpayer’s income or, in other words, in which it has been reflected as an accrual forming part of the taxpayer’s gross income. This provision is quite clearly based on the principle that an amount must be treated as an accrual despite the fact that it might never be recovered in full from the debtor.

The general part of the definition of ‘gross income’ does not presuppose the deduction of any expenditure. An expense or loss can be deducted only if the general deduction formula (s 11(a) read with ss 23(f)–(g) and 23B(3)), or a specific deduction so provides. So a court can concern itself only with deductions permissible according to the language of the Act, and not with deductions made in a taxpayer’s books

of account (see, for example, *Joffe & Co Ltd v CIR* 1946 AD 157 at 165; *SIR v Eaton Hall (Pty) Ltd* 1975 (4) SA 953 (A) at 958B–E; *CIR v Nemojim (Pty) Ltd* 1983 (4) SA 935 (A) at 946G–H and 957C–D). Expenditure can be deducted in terms of the general deduction formula only in the tax year in which it is actually incurred — the tax year in which a taxpayer incurs an unconditional legal obligation, even if that obligation is discharged only in a later year. An unconditional liability that becomes the subject of a genuine dispute in the tax year in which it arises does not, however, qualify as an expense actually incurred during that year, if that dispute is still unresolved at the end of that year (*CIR v Golden Dumps (Pty) Ltd* 1993 (4) SA 110 (A) at 118F–H).

A contingent liability is not, generally, recognized as an actual expense, no matter how strong the likelihood of such expense (see, for example, *Nasionale Pers v KBI* 1986 (3) SA 549 (A) at 564A–D; *Edgars Stores Ltd v CIR* 1988 (3) SA 876 (A) at 888–889). Moreover, the Act prohibits a deduction in respect of income capitalized or transferred to any reserve fund (s 23(e)), in this way preventing a deduction in respect of a contingent expense or loss unless specifically allowed. The specific exceptions to the general rule regarding the non-recognition of contingent or likely expenses include the provision for the deduction of expenditure likely to be incurred within five years on the repair of a ship used for purposes of trade (s 14(1)(c)), and the unexpired insurance-risks allowance (s 28(2)(d)).

The recognition of an expense in the tax year in which the unconditional obligation is incurred may, of course, be subject to specific rules deferring the deduction to a later year (on the acquisition of trading stock, see s 23F), or spreading it over more than one tax year (s 23H). But these rules do not detract from the fact that an unconditional obligation is recognized as an expense despite the fact that in the end it may fall away, become unenforceable, or be discharged for an amount differing from that initially claimed as a deduction. The mere possibility that a contract giving rise to a liability may be varied or cancelled, or even breached, is not recognized as a contingency that renders that liability (or the corresponding accrued right of the creditor) conditional (see Van Dijkhorst J in *ITC 1587* (1995) 57 SATC 97 at 106). This is also confirmed by the fact that an amount can be recouped in the same tax year in which it is recognized as an expense actually incurred. This implies that a person can claim the full amount of an expense incurred during a tax year even though a portion of it is recovered or recouped during the same year. It is clearly based on the premiss that an expense must be quantified as at the date during a tax year when the unconditional liability is incurred. What is to be reflected, when claiming a deduction in respect of a liability still undischarged at the end of a tax year, is, therefore, the amount of the liability as at the date on which it was incurred, and not as at the last day of the tax year. Any recoupment

or recovery, during that year, of a portion of the deduction so claimed must, according to the wording of the recoupment provision, be taken into account as a separate item. This brings us to the crucial question — does the Act require an anticipated but unrealized benefit (in the form of a likely reduction of the amount required to discharge that liability, or an anticipated failure of the creditor to claim it) to be brought into account as a recoupment?

3.2.3 The Non-recognition of Unrealized Profits or Losses

The Act recognizes, generally, only unconditional rights and obligations. Unrealized profits or losses are not recognized unless they are specifically provided for in the Act. Specific exceptions include deemed gains under share-option schemes (s 8A), gains and losses from foreign exchange transactions (s 24I), provision for bad and doubtful debts (s 11(i) and (j), respectively), repairs to ships (s 14(1)(c)), and certain allowances for short-term insurers (s 28(2)(d)).

Section 22(1)(a) contains what is probably the most important exception to the general rule regarding the non-recognition of unrealized losses: a taxpayer may value trading stock (other than shares held by a company) not disposed of as at the end of a tax year ('closing stock') at the lower of cost or market value. This accords with accounting practice in respect of closing stock, and enables a taxpayer to provide for an anticipated but unrealized loss on the future sale of stock that has, for example, become obsolete or has depreciated for other reasons. This practice was applied for tax purposes from 1914 to 1956 without any legislative sanction (see Walter J Barnes *Income Tax Practice in South Africa* (1919) 13, 50n35, 130, 134 and 193–195, and *Income Tax Handbook* (1925) 117; *Barnes' Income Tax Handbook* 5 ed by AW Osborn & H Rothschild (1944) 170–171; Frank William Anton Eveleigh *Income Tax Guide* (1917) 9; CJ Ingram *The Law on Income Tax in South Africa* (1933) 101). This practice was sanctioned in 1923 in *CIR v Jacobsohn* 1923 CPD 221 at 231, despite the fact that the court acknowledged that a fall in the market value of closing stock did not constitute a loss actually incurred in the production of income. Innes CJ differed, not surprisingly, with some of the reasoning in *Jacobsohn*, but refrained from expressing any opinion on the court's decision (*CIR v George Forest* supra at 524–525). Only unrealized losses were, however, taken into account when valuing closing stock for tax purposes and not unrealized gains, as any appreciation in the value of such stock was not considered to be income within the meaning of the 1941 Act until it was realized (*Barnes' Income Tax Handbook* 6 ed by AW Osborn (1947) 177). Different commentators pointed out that there was no statutory basis for the practice of taking unrealized losses into account in respect of closing stock (see the editorial 'Opening and Closing Stock in Trade' (1955) 4 *The Taxpayer* 21 at 23; AS Silke *Tax Avoidance and Tax Reduction* (1958)

472 248). In 1956, this practice was sanctioned (s 11(5) of the 1941 Act as inserted by s 6(f) of the Income Tax Act 55 of 1956) following various recommendations to this effect (see *First Report of the Committee of Enquiry into the Income Tax Act* (1951) (UG 75-1951) 29–30 36; *First and Final Report of the Income Tax Commission* (1953) (UG 11-1954) 11 41)). This amendment was clearly required in view of the general principle regarding the non-recognition of unrealized losses and gains: the Commissioner had, as was acknowledged in Parliament ((1956) 92 *Hansard* 6 June 1956 col 6963), effectively been acting outside the law by allowing taxpayers to take such unrealized losses into account.

It is clear, from the history of the recognition of unrealized losses in respect of trading stock, that the underlying principle that unrealized savings or gains and losses cannot be taken into account for tax purposes unless specifically allowed, was embedded in the various income tax consolidation statutes. Case law, generally, reflects this position. Although it was accepted in *Lategan* (supra at 210–211) and *People's Stores* (supra at 365G and 367E–F) that the face value of a right that is not payable during the tax year in which it accrues must be reduced to reflect the present value of the amount payable in the future, this allowed only the time value of money to be taken into account, and not the possibility or likelihood of non-payment. So the *People's Stores* approach to the quantification of an accrual is not based on the implicit recognition of an unrealized loss. This valuation principle was, in any event, overridden by Parliament with retrospective effect (the proviso to the definition of 'gross income' in s 1). The wording of this amendment is of more than passing interest — it applies to any amount to which a taxpayer has become entitled during a tax year. This clearly suggests that an accrual should be valued as at the date on which the taxpayer's entitlement arises, and not at as the end of the tax year in which it arises. In *Caltex Oil (SA) Ltd v SIR* 1975 (1) SA 665 (A), however, the court adopted an approach to the date of quantification of an expense incurred in foreign currency that departs, on closer examination, from the general principles regarding unrealized gains and losses. By holding (at 674C–D, 675E–F, 675–676 and 676H) that a liability incurred in foreign currency has to be quantified not as at the date of its incurral during a tax year but as at the date of its actual discharge, or, if not discharged during that year, as at the end of that year, the court recognized exchange-rate fluctuations after the date of a transaction. This approach effectively recognizes a potential but unrealized saving or loss as at the end of a tax year, and so ignores the implications of the statutory formula governing the determination of a taxpayer's taxable income. The time as at which the necessary accounting entries are made when quantifying an expense incurred in foreign currency clearly influenced the court (at 675A). These views are rather surprising, given its reliance on the principle that a court is concerned only with deductions that are permissible according to the

language of the Act, and not with debits made in a taxpayer's books of account (at 676H).

The court never considered whether a realized saving in the amount in rand actually expended during a tax year to discharge a liability incurred earlier that year would constitute a recoupment (at 678E). So the court was never faced with the issue whether its approach regarding the quantification, at the end of a tax year, of an undischarged expense could be reconciled with the clear intention of Parliament, as inferred from the wording of the general recoupment provision, regarding the date of quantification of an expense.

The judgment in *Caltex Oil* regarding the treatment of foreign exchange gains and losses has been superseded by section 24I (as inserted by s 21 of the Income Tax Act 113 of 1993), but the principles set out by the court remain relevant in respect of any debt incurred in kind that is not discharged during the year in which it is incurred (for example, in the case of a contract of barter, or exchange). The quantification of a liability at the end of the tax year in which it was incurred involves, as pointed out by Meyerowitz (editorial 'Unrealized Foreign Exchange Losses and the "Second Year" Problem' (1987) 36 *The Taxpayer* 121 at 123–124), the recognition of notional gains or losses. But these gains or losses are no more notional at the end of the tax year in which a liability was incurred than at the end of any later year in which that liability remains outstanding. The approach in *Caltex Oil* clearly opened the door for the recognition of such unrealized gains and losses in later tax years despite the fact that the court refrained (at 677–678) from expressing any opinion in this regard.

The next important pronouncement on the tax status of unrealized foreign exchange gains and losses that arise in a tax year in which the debt to which they relate was neither incurred nor discharged, is that in *Plate Glass & Shatterprufe Industries Finance Co (Pty) Ltd v SIR* 1979 (3) SA 1124 (T). The initial appeal to the Special Court failed on the ground that, although an adjustment may have been necessary for purposes of proper accounting, this merely indicated a notional loss, and not a loss that had been actually incurred (at 1127G–H). But in the further appeal Margo J expressed the following view (at 1127–1128):

[T]here is logic in adopting the accounting method to determine liabilities or losses. . . . Here, since part of the loan was repayable on demand at the end of any of the 120-day periods, the liability continued for each tax year until it was repaid. If, . . . after such a liability has been brought to account in an increased amount because of a loss caused by a change in the rate of exchange, there should be an improvement in the rate . . . resulting in a profit, or a reduction of the loss, that would have to be accounted for as at the later date. . . . The ultimate actual profit or loss would then be properly brought to account in this way.'

Margo J clearly embraced accounting principles that departed from the general tax principle regarding the non-recognition of unrealized gains or losses. In this way he effectively extended the *Caltex Oil* principle

to tax years following that in which a liability was incurred. Strong doubts were, not surprisingly, expressed by various commentators about the recognition of unrealized gains and losses implicit in Margo J's reasoning (for example, C Divaris 'Foreign Exchange Losses on Loans: The *Plate Glass Case*' (1980) 19 *ITR* 29; Silke op cit 7.5; Fiona Walker 'Tax Treatment of Foreign Exchange Gains and Losses' (1987) 2 *SA Tax J* 34 at 42, 44 and 53). The views expressed by Margo J were obiter, and eventually failed to find favour with the then Appellate Division in *CIR v Felix Schuh (SA) (Pty) Ltd* 1994 (2) SA 801 (A)). In holding (at 812D–G) that a loss would actually be incurred in respect of a foreign loan only upon its actual payment in rand, Corbett CJ reaffirmed the basic principles regarding the recognition of expenditure and the corresponding unsoundness of Margo J's views regarding the adoption of accounting principles (at 812–813). Moreover, Corbett CJ (at 814D–E) considered the position to be so clear in our law as to exclude any need to look for persuasive authority in Australian or English case law.

The court's approach in *Felix Schuh* represents, to my mind, a departure from the *Caltex Oil* approach, despite the court's attempt to distinguish the latter case. Corbett CJ effectively reaffirmed the basic principle regarding the non-recognition of unrealized gains and losses, however prudent and proper from an accounting point of view it may be to provide for them.

3.2.4 Events Recognized as a Recoupment

The Act recognizes an unconditional right or entitlement and an unconditional obligation measurable in money as an accrual and an expense, respectively. The general deduction formula treats an unconditional liability, quantified as at the date of its incurral, as a realized expense or loss prior to its actual discharge. I argued above that the general recoupment provision gives effect to the principle that an expense or loss will qualify as a deduction only to the extent to which the taxpayer has actually borne it. So an obligation that has been recognized as an expense that is deductible in terms of the general deduction formula will be recouped if that obligation is discharged for a lesser amount than that originally so recognized. An event occurring prior to the discharge of that obligation may also constitute a recoupment. The general rule applied in *Felix Schuh* regarding the recognition of realized gains or losses requires the recognition of an event as a recoupment if that event results in an actual saving or benefit for the taxpayer, and not in the mere likelihood of it. So a quantifiable and enforceable benefit either affecting the actual extent or continued existence or enforceability of that obligation will be recognized as a recoupment. But there will be no recoupment if the quantified amount of an obligation is subject to fluctuation in the period prior to its discharge because of external factors (such as currency fluctuations, or fluctuations in the price of goods still to be acquired by

the taxpayer for delivery to the creditor), which gives rise to a potential or likely saving or loss. The position changes once the obligation is varied contractually or by operation of law, which wholly or partly relieves the taxpayer from that obligation. Such variation or waiver of or release from the obligation affects the extent to which the obligation initially recognized as a deduction will borne by the taxpayer. It results, in terms of general principles, in a realized gain or entitlement equal to the amount by which the previously recognized legal obligation has been reduced. The amount of that legally recognized reduction clearly qualifies as a recoupment (for a contrary view, see ‘Recent Cases — Appropriation of Funds by Agent’ (2000) 39 *ITR* 11 at 12). So the finding by Wunsh J (at 258) and Conradie J’s view that the reduction or cancellation of a liability that has been allowed as a deduction represents an accrued benefit that has to be reflected as a recoupment, are supported by the general principles of the Act regarding the recognition of rights and obligations — the extinction of the obligation or debt is, in the words of Conradie J (*ITC 1704 supra* at 263G), ‘the correlative of the extinction of the creditor’s right of action’.

An expense allowable as a deduction may, of course, also be recouped where the taxpayer becomes entitled to be compensated for the expense so recognized. A recoupment will, therefore, arise if the taxpayer becomes unconditionally entitled, as against, for example, an insurer, to recover such expense, or to be recompensed for it. The right or amount involved must bear a direct relationship to the previously recognized deduction or the underlying obligation involved (see *CSARS v Pinestone Properties CC* (2001) 63 SATC 421 at 427–428). But the principles governing the recovery of an expense fall outside the scope of this comment.

Conradie J’s approach to a prescribed debt raises another important issue. He refers (at 261B–D) to the fact that the debtor involved may still successfully have to invoke this defence in order to extinguish the obligation. Conradie J deals with this issue by assuming, on the facts before him, that the treatment of the prescribed debts in the taxpayer’s books of account has the effect of extinguishing them. This assumption is clearly based on the reasoning that a prescribed debt has to be reflected as a recoupment only once it has been extinguished. Is this assumption justified? The answer, to my mind, is to be found in the rules governing the recognition of a right or entitlement. In the words of Conradie J (at 263F–G): ‘[I]f the value of a right can . . . be said to accrue to a taxpayer, the value of a defence, such as prescription — a right to be released from liability — should not in principle be treated differently.’

The position of a debtor in respect of a liability that has prescribed does not, to my mind, differ in principle from that of a holder of an unconditional right. The recognition of that right as an accrual is not affected by the fact that the person entitled to it may still have to claim or enforce performance in terms of it, that its enforcement may not succeed,

or that such holder may even decide not to enforce it. The mere possibility that such events may arise does not absolve the taxpayer from reflecting the right as an accrual. The same applies to the debtor's right to invoke the defence of prescription against a claim for the discharge of an obligation. The defence arising by operation of law affects the enforceability of such obligation and qualifies as a recoupment of that obligation even before it is invoked. So its recognition as a recoupment is not governed by the taxpayer's accounting practices in this regard, by whether the defence of prescription has actually been invoked by the taxpayer, or even by whether the taxpayer actually intends to invoke or rely on this defence. There was no need, therefore, for Conradie J to assume that the prescribed debts had been extinguished. The facts in *ITC 1704* supra at 261A–B also illustrate that the taxpayer's accounting treatment of the prescribed debts as no longer payable could in any event not be seen as indicative of the extinction of those debts or even of the taxpayer's intention to invoke the defence of prescription — the taxpayer was clearly keeping open the option of paying a claim even after a debt had prescribed if it thought it prudent to do so. Moreover, the accounting entries could, quite simply, not have triggered a recoupment in the absence of a change in the underlying legal rights and obligations between the taxpayer and its creditor.

To conclude: a recoupment will also arise if the amount of a debt is reduced or waived, or if its enforceability is affected by prescription. The question that arises, in view of this conclusion, is whether there was any real need for the enactment, in this regard, of the provisions contained in section 8(4)(m).

3.2.5 The Function of Section 8(4)(m)

Section 8(4)(m) provides, essentially, that if a person is during any tax year wholly or partially relieved, 'as a result of the cancellation, termination or variation of an agreement or due to the prescription, waiver or release of a claim for payment', of an obligation 'to make payment of any expenditure actually incurred' in respect of which a deduction or allowance was allowed in that year or any previous year, that person shall, subject to section 20, be deemed to have recovered or recouped an amount equal to the amount of the resultant relief (although the wording suggests that the recoupment is 'equal to the amount of the obligation' (see Meyerowitz *Meyerowitz on Income Tax* 9.78n4). It was argued in *Omnia Fertilizer* (at 164G–I) that the introduction of section 8(4)(m) in 1997 (by s 6(1)(b) of the Income Tax Act 28 of 1997) indicated that Parliament had always intended that a recoupment necessarily involved the extinction of a legal obligation recognized as an expense. The court responded (at 164I–J):

'Release from indebtedness is not entailed in the ordinary meanings of "recovered" or "recouped". Termination of liability is not itself a recoupment. It merely enables

recoupment. If anything the new paragraph detracts from the taxpayer's argument because it signifies that ordinarily the termination of legal liability is not a requirement for recoupment. There was therefore a need for the inserted paragraph to introduce the deemed meaning.'

The court's reasoning and its underlying logic is rather difficult to follow. The view that the termination of liability 'is not itself a recoupment' but merely enables recoupment, implies that the taxpayer must take 'some or other step' (see at 163I–J) to recoup the amount of the liability that has fallen away. This ties in with the court's view (at 163G–H) that an unpaid debt is recognized as an expense on the basis of 'an assertion by the taxpayer, accepted and acted upon by the Commissioner, recognizing the likelihood . . . that the debt will be paid' and that such expense is recouped if the taxpayer 'in effect erases the debt from its books and treats the amount concerned as available for another purpose'. The court's stance seems to suggest that the resultant saving will constitute a recoupment only once the taxpayer has recognised it as such in its books of account. It follows that a benefit resulting from the actual variation or termination of legal rights and obligations or the impairment of their enforceability will qualify as a recoupment only at the time and to the extent to which the taxpayer recognises it for accounting purposes. So the taxpayer's accounting treatment determines the tax consequences of the variation or termination of legal obligations. This cannot be squared with the general principles of the Act regarding the recognition of unconditional rights and obligations. The basis for the recognition of an unpaid debt as an expense is not the assertion made by the taxpayer in this regard, but the fact that the debt qualifies as an unconditional obligation. The same applies to the subsequent erasure by the taxpayer of that debt from its accounts. The taxpayer's accounting entry does not as such qualify as a recoupment. A recoupment can arise only if a legally enforceable benefit accrues to that taxpayer as a result of a change in the legal relationship between that taxpayer and the creditor involved. The resulting accrued benefit qualifying as a recoupment must, moreover, be disclosed as such, irrespective of whether it is disclosed for accounting purposes. As was said in *SIR v Silverglen Investments* 1969 (1) SA 365 (A) at 377A–C):

'The requirement that receipts as well as accruals must be disclosed, with the provision for a penalty and additional taxation, and the levy of the tax on both receipts as well as accruals, clearly indicate that Parliament contemplated an assessment of the tax in every year also on accruals during that year. . . .'

Even if it could be argued that a receipt or accrual may be taxed in the year of accrual, or, where it is disclosed only in the year of receipt, the latter year, and that a taxpayer is therefore given a choice regarding the tax year in respect of which it is to be so disclosed (an argument that I find unsound (see Meyerowitz *Meyerowitz on Income Tax* 6.5)), there is no subsequent receipt to be disclosed as such after a liability has prescribed, fallen away, or been reduced. So a reduction, waiver, or

prescription of a debt previously recognized as a deductible expense must be taken into account as a recoupment in the tax year in which that benefit accrues to the debtor irrespective of whether that debtor discloses it as such.

The court's view that section 8(4)(m) signifies that ordinarily the termination of legal liability is not a requirement for recoupment, is also somewhat puzzling. It suggests, at first blush, that something less will suffice, a position that is consistent with the court's view (at 163B–C) that Parliament could simply have said so had it intended that an amount allowed as a deduction was to be recouped only if the underlying legal liability ceased to exist. But if an anticipated saving that is not yet legally enforceable constitutes a taxable recoupment, the extinction of the liability would in any event also qualify as a recoupment, thus rendering the deeming provision superfluous. It seems, however, that the court views section 8(4)(m) as serving the function of extending the meaning of 'recoupment' to cover the termination of a liability recognized as an expense. But if a specific provision is needed for the recognition, as a recoupment, of the termination of a legal liability, the same surely applies, in the light of the general non-recognition of unrealized gains and losses, where a legal liability is not terminated, but merely unlikely to be enforced by the creditor.

Is the court's reasoning perhaps based on the assumption that section 8(4)(m) dispenses, in respect of a prescribed debt, with the requirement that a debt must be extinguished in order to be recouped, as suggested by Meyerowitz (Editorial note 'Income Tax — Income — Expenditure Incurred but Unpaid — Taxpayer later Including it in Profits — whether Amount Constitutes a Recoupment' (2002) 51 *The Taxpayer* 30 at 31)? I argued above that the benefit of prescription qualifies as a recoupment even before it has been invoked by the debtor. Section 8(4)(m) has in my view not brought about any change in this regard, nor extended the meaning of section 8(4)(a) in this respect.

Section 8(4)(m) deals, to my mind, with an issue flowing from the simultaneous introduction in 1941 of the general recoupment provision and the provision requiring, broadly, a compromise benefit granted by a taxpayer's creditors to be deducted from an assessed loss of that taxpayer (s 11(3) of the 1941 Act; now s 20(1)(a)(ii)). This raised the issue whether benefits from the extinction, remission, reduction, or waiver of a debt constituted a recoupment (WJ Barnes *New Taxation* (1941) 45–46). Should a compromise benefit constitute a recoupment under section 8(4)(a) as well as a benefit reducing a taxpayer's assessed loss under section 20(1)(a)(ii), it would mean that such taxpayer would have to add the amount of the benefit to its income for a tax year, and, where its activities for that tax year resulted in an assessed loss, reduce that assessed loss by the amount of that benefit. But such compromise benefit would already have reduced that assessed loss indirectly as a result of its

inclusion, as a recoupment, in the taxpayer's income before the determination of that assessed loss. So the taxpayer would be exposed to the possibility of the double taxation of a compromise benefit if such benefit fell within the ambit of both provisions. In *CIR v Louis Zinn Organisation (Pty) Ltd* 1958 (4) SA 477 (A) at 485C–E, Schreiner ACJ referred to the difficulty of co-relating the recoupment and assessed loss provisions adopted simultaneously in 1941. A construction including compromise benefits under the recoupment provision would render the assessed loss provision superfluous but would, in turn, create other anomalies. However, the court found it unnecessary to decide whether the view expressed by the Special Court — that a reduction of a liability under a compromise could never be a recoupment (see at 479A–B and 484E–F) — was correct.

The recoupment and assessed loss provisions were re-enacted in the same form in 1962. The issue regarding the meaning of and relationship between the general recoupment and reduction of assessed loss provisions remained, however, unresolved. This issue was raised again in *ITC 1634* (supra) and *ITC 1704* (supra) a few months before the introduction of section 8(4)(m) during 1997 (for a review of the case law and arguments in this regard, see *ITC 1634* supra at 242–245), a fact of which Parliament must have been aware at the time. Once it is accepted that the benefit flowing from the remission or waiver of a debt constitutes a recoupment (irrespective of whether such benefit arises under a compromise with creditors (for a contrary view see *Silke* op cit 7.48), there remains, as is also clear from the judgment of *Wunsh J* (at 245–246), the difficulty of reconciling sections 8(4)(a) and 20(1)(a)(ii). In deeming the benefit from the cancellation, termination, or variation of an agreement, or due to prescription, waiver, or release from a claim to be a recoupment, section 8(4)(m) effected no real change. But in providing that the recoupment provision is subject to section 20, it lays down the order of precedence, in this way ensuring that a compromise benefit is not taken into account twice.

So section 8(4)(m) does not extend the meaning of 'recoup' within the context of s 8(4)(a) but deals with the interrelationship between sections 8(4)(a) and 20. It follows that it provides no support for the view that a possible or potential benefit that is reflected for accounting purposes constitutes a recoupment for tax purposes. I shall now turn to the question whether 'recoup' bears the same meaning in the context of the Eighth Schedule.

4 Recoupments in the Context of Capital Gains and Losses

Capital gains and losses are determined with reference to a disposed asset's 'base cost' and the 'proceeds' from its disposal (see paras 3 and 4 of the Eighth Schedule). It is clear from the scheme of the Eighth Schedule that the basic concepts 'receipts or accruals' and 'expenditure

actually incurred' are also integral to the scheme for the determination of a capital gain or loss. A 'recoupment' can arise within the context of an asset's base cost. Specific categories of 'expenditure actually incurred' qualify, generally, as part of an asset's base cost (para 20(1) of the Eighth Schedule). But there is one important qualification — an unconditional obligation will be recognized as part of an asset's base cost only once it has been paid, or has become due and payable (para 20(3)(c) of the Eighth Schedule). But any amount so paid, or due and payable, will not qualify as base cost to the extent to which it 'has for any reason been reduced or recovered or become recoverable from or has been paid by any other person (whether prior to or after the incurral of the expense to which it relates)' (para 20(3)(b) read with para 20(3)(c) of the Eighth Schedule). A recoupment may also arise in a tax year after that in which an asset was disposed of, in which case so much of the base cost previously taken into account when determining the capital gain or loss from that disposal 'as has been recovered or recouped', will constitute a capital gain (para 3(b)(ii) of the Eighth Schedule). The reduction of such base cost, or the recognition of such capital gain may result in corresponding adjustments, for tax purposes, in the hands of the creditor entitled to the corresponding right involved. This will occur where that right qualifies as part of the proceeds from the disposal of that asset by that creditor to that debtor (para 35(1) of the Eighth Schedule). Provision is made, in such instance, for a reduction of an accrued amount forming part of such proceeds or for the recognition of a corresponding capital loss in the hands of that creditor. The resulting reduction of proceeds or capital loss will be equal to the amount to which the creditor is no longer entitled 'as a result of the cancellation, termination or variation of any agreement, or due to the prescription or waiver of a claim or a release from an obligation or any other event' (paras 35(3)(c) and 4(b)(i)(aa) of the Eighth Schedule (there are minor differences in the wording of these provisions)).

Provision is also made for the recognition, in certain circumstances, of a capital gain in the hands of a debtor where the creditor to whom that debtor owes a debt waives or reduces that debt without full consideration for such relief (para 12(5) read with paras 3(b)(ii), 20(3) and 56 of the Eighth Schedule, and s 20(1)(a)(ii)). The consideration for such relief may, of course, consist of the disposal of an asset by that debtor to the creditor, in which case such relief will be taken into account as part of the proceeds from that disposal (para 35(1)(a) of the Eighth Schedule) and not as a separate capital gain.

The various provisions referred to above have one characteristic in common — the recognition, for purposes of the Eighth Schedule, of changes in legal rights and obligations affecting the amount of a debt that is legally enforceable. A debt reduction or extinction that is merely likely and not yet enforceable will, generally, not be recognized as a recoupment

or as a gain in the hands of a debtor irrespective of the debtor's accounting treatment of the expected or likely benefit. The same applies where the debt is unlikely to be enforced but has not yet prescribed.

5 The Subsequent Payment of a Prescribed Debt

Meyerowitz (Editorial note 'Income Tax — Income — Transfer of Unpaid Liability (not Prescribed) from Suspense Account to Profit and Loss — Whether a Recoupment of Expenditure' (1998) 47 *The Taxpayer* 229 at 230) raises a further issue regarding the view that a liability that has not yet prescribed is recouped where the taxpayer chooses to ignore that liability for accounting purposes. There is always the possibility, as the facts in *ITC 1634* supra at 257 illustrate, that a creditor may claim payment of a liability so 'recouped' in a year subsequent to that in which it was recouped. Would the resulting payment of a debt treated as having been recouped in a previous year qualify as a deductible expense in the year of payment? Wunsh J clearly thought that it would. Meyerowitz does not share this view but notes that an expense is, generally, recognized as a deduction only in the tax year in which it is incurred (see *Sub-Nigel Ltd v CIR* 1948 (4) SA 580 (A) at 589). The liability so paid would, in his view, have been incurred and recouped in tax years prior to that in which it was paid. The recoupment would effectively have neutralized the deduction of the expense in an earlier tax year. No new obligation would have been incurred in the year of payment. The amount so paid would, therefore, not qualify as an expense incurred in the year of payment, and so would not be deductible.

A moment's reflection will show that the issue raised by Meyerowitz can also arise in the context of an actual recoupment, as in *ITC 1704* supra at 261A–B, where the taxpayer would have paid out a claim after the obligation had prescribed, had it considered it prudent to do so in view of its continuing business relationship with the creditor. Payment of or performance in terms of a prescribed obligation would not be made in respect of a new obligation incurred during the year of payment. But a payment is not disqualified as a deduction merely on the ground of the absence of a preceding enforceable obligation (see *Provider v COT* 1950 (4) SA 289 (SR) at 290D–G and 291D–E). Such payment still qualifies as an expense. Its deductibility will depend on whether it meets the requirements of the general deduction formula (see s 11(a) read with ss 23(f) and (g) and 23B(3)), or of a specific deduction. It should, for example, be deductible in terms of the general deduction formula if it is not of a capital nature and passes the crucial hurdle of having been made in the production of income. So it will have to form part of the expenses so closely connected to the 'performance of a business operation *bona fide* performed [by the taxpayer] for purpose of earning income . . . that they may be regarded as part of the cost of performing it' (*Port Elizabeth Electric Tramway Co Ltd v CIR* 1936 CPD 241 at 246). A payment that is

so closely connected to the taxpayer's business operations should qualify as a deduction whether such payment is necessary for the performance of those operations, attached to them by chance, or bona fide incurred for their more efficient performance.

6 Conclusion

An economic benefit or burden may, generally, be recognised for income tax purposes only if such benefit or burden qualifies as an unconditional right or entitlement, or as an unconditional obligation or liability, respectively. This has been the position since at least 1917. Events resulting in or affecting such rights or obligations may be recognized for tax purposes only if they result in realized gains or losses, or if they are specifically recognized by the Act. A long line of judgments confirm that these principles override accounting principles. It is clear from the history of the general recoupment provision in section 8(4)(a) as well as from its context in the Act that it extends only to a realized saving or gain in the form of a quantifiable and legally enforceable benefit. This also applies to the recoupment of a debt that has been recognized as an expense and allowed as a deduction, and that has not yet prescribed. Should a taxpayer decide not to reflect the amount of that debt as a liability for accounting purposes on the ground that the creditor is unlikely to enforce its payment, that amount may, for accounting purposes, have 'reverted to the taxpayer's "pocket"', to use the court's words in *Omnia Fertilizer* (at 163H–I). But that accounting entry will not reflect a legally enforceable benefit but merely an anticipated and as yet unrealized saving or gain. A recoupment will arise only to the extent to which the underlying liability is reduced or extinguished, or its enforceability is affected, whether in terms of a waiver, or the variation of the contract giving rise to it, or by means of prescription.

The recognition as a recoupment, in *ITC 1634* and *Omnia Fertilizer*, of accounting entries reflecting expected but as yet unenforceable savings or gains cannot be reconciled with the above principles. The same can be said of the recognition, in *Caltex Oil*, of unrealized gains and losses occurring between the date of incurral during a tax year of an expense and the end of that year. But, in *Felix Schuh*, the court refrained from extending the *Caltex Oil* principle to later tax years. It reaffirmed the basic rules regarding the non-recognition of unrealized gains and losses. No such limitation applies in respect of the *Omnia Fertilizer* approach: it can, in principle, be applied in any year in which a taxpayer chooses to ignore, for accounting purposes, a legal liability still owed to another. This approach brings into question some fundamental principles of our income tax law. It will be interesting to see whether Revenue will adopt this approach and perhaps even attempt to apply it outside the ambit of the general recoupment provision. I have some doubts whether our courts will be willing to extend an approach that is not specifically embodied in

the Act and that runs counter to entrenched principles and a long line of case law. Any recognition, as a recoupment or an accrual, of accounting entries reflecting as yet unenforceable benefits in the end rests on what can be described only as somewhat shaky reasoning.
