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## INCOME EARNED FROM AN ILLEGAL INVESTMENT SCHEME — A CASE STUDY

In 2006, Mr D, a South African resident and renowned businessman, operated an illegal investment scheme in Soweto. He solicited funds from investors, which were deposited in his account in return for commission. He procured a range of convincing-looking documentation issued to investors when they made deposits. He promised the investors irresistible (but unsustainable) returns on various forms of investments. For a while, he paid such return to some of the investors but the scheme collapsed, owing R10 million. Mr D knew that the scheme was fraudulent and that it would be impossible to pay all the investors what they had been promised.

**What are the income tax implications for Mr D? Are the amounts paid by the investors taxable in his hands?**

Section 1 of the Income Tax Act (the Act) defines 'gross income' in relation to a resident as "... the total amount, in cash or otherwise, received by or accrued to or in favour of such resident..." In this case it is clear that funds were physically deposited by investors into Mr D's account so it is not necessary to consider the part of the definition relating to accrual, but it needs to be ascertained whether these funds constitute an amount received by him.

### The meaning of 'received by'

There are several court cases dealing with this phrase. In *Geldenhuys v CIR* the court held that these words must mean something received by the taxpayer on his own behalf and for his own benefit. This view was echoed in *SIR v Smart and Minister of Finance* and another *v Law Society Transvaal*.

Turning to the facts of this case, Mr D physically received money when investors deposited funds into his account. The question is whether he received these funds for his own benefit or on his own behalf.

It is tempting from the general meaning of 'received by' to come to the conclusion that every incidence where physical control is obtained over money is an incidence where an amount has been received. This is, however, not the case. If the amount was received by the taxpayer on his behalf and for his own benefit, then the amount has been received for purposes of the definition of 'gross income'. If the money was however received not for his benefit or on his own behalf, then there is no receipt and the taxpayer is not liable for tax on the amount despite the fact that he has physical control of it. Examples of cases where money is received not for own benefit is a receipt by a nominee shareholder – the receipt is in favour of the beneficial owner of the shares. Similarly, income received by a trustee of a trust will either be taxable in his hands in his representative capacity or in the hands of the beneficiaries who are entitled to the income. In *CIR v Genn & Co (Pty) Ltd*, the court held that borrowed money does not qualify as money received by the taxpayer, because as soon as he obtains the money, he incurs an obligation to repay it.

In 1981, the courts in Zimbabwe had to deal with a situation where the taxpayer misappropriated funds in his care. The relevant legislation contained a provision similar to our definition of 'gross income'. The Court held that the word 'received' in that provision had to be ascribed its ordinary meaning, namely the taking into own hands or possession of money or taking delivery of a thing from another. What was interesting though is that the Court held that this meaning could not extend