



THE SUPREME COURT OF APPEAL OF SOUTH AFRICA
JUDGMENT

Reportable

Case no: 1147/2019

In the matter between:

CITY POWER (SOC) LIMITED

APPELLANT

and

**THE COMMISSIONER FOR THE SOUTH AFRICAN
REVENUE SERVICE**

RESPONDENT

Neutral citation: *City Power (SOC) Limited v CSARS* (1147/2019) [2020]
ZASCA 150 (20 November 2020)

Bench: PONNAN, SALDULKER and MAKGOKA JJA and MATOJANE and
SUTHERLAND AJJA

Heard: 6 November 2020

Delivered: This judgment was handed down electronically by circulation to the parties' representatives via email, publication on the Supreme Court of Appeal website and release to SAFLII. The date and time for hand-down is deemed to be 10:00 am on 20 November 2020.

Summary: Income Tax Act 58 of 1962 – appellant not a municipality or local sphere of government – appellant's accruals and receipts not exempt from normal tax under s 10(1)(a) and (b).

ORDER

On appeal from: Tax Court of South Africa, Gauteng (Victor J): judgment reported *sub nom ABC Limited v Commissioner for the South African Revenue Service* [2019] ZATC 11.

The appeal is dismissed with costs, including those of two counsel.

JUDGMENT

Ponnan JA (Saldulker and Makgoka JJA and Matojane and Sutherland AJJA concurring)

[1] The issue for determination in this appeal, against a judgment of the Tax Court (Victor J, sitting in Gauteng), is whether the appellant's accruals and receipts are exempt from normal tax under s 10(1)(a) and (b) of the Income Tax Act 58 of 1962 (ITA).

[2] The appellant, City Power (SOC) Limited (City Power), is a state-owned company, registered as such in terms of the Companies Act 71 of 2008.¹ On 2 June

¹ A 'state-owned company' is defined in s 1 of the Companies Act 71 of 2008 as: '[a]n enterprise that is registered in terms of this Act as a company, and either—

2014 the respondent, the Commissioner for the South African Revenue Service (SARS), issued income tax assessments in respect of the 2010-2012 years of assessment and disallowed doubtful debt allowances claimed by City Power.

[3] City Power had contended that, because it is a municipal entity² and performs the functions that would otherwise have been performed by the City of Johannesburg (the City), it qualified for an exemption under:

- (a) section 10(1)(a) of the ITA, with effect from 1 January 2011; and
- (b) section 10(1)(b), prior to that date.

It accordingly objected to the assessment and, upon the objection being disallowed, appealed to the Tax Court. By agreement between the parties, this issue was determined *in limine*, and separately from the merits, by the Tax Court.

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- (a) is listed as a public entity in Schedule 2 or 3 of the Public Finance Management Act, 1999 (Act 1 of 1999); or
 - (b) is owned by a municipality, as contemplated in the Local Government: Municipal Systems Act, 2000 (Act 32 of 2000), and is otherwise similar to an enterprise referred to in paragraph (a)...

² The definitions section of the Local Government: Municipal Systems Act 32 of 2000 (the Systems Act) provides that a 'municipal entity' is:

- (a) a private company referred to in s 86B(1)(a);
- (b) a service utility; or
- (c) a multi-jurisdictional service utility...

A 'municipal service' is in turn defined to mean 'a service that a municipality in terms of its powers and functions provides or may provide to or for the benefit of the local community irrespective of whether—

- (a) such a service is provided, or to be provided, by the municipality through an internal mechanism contemplated in section 76 or by engaging an external mechanism contemplated in section 76; and
- (b) fees, charges or tariffs are levied in respect of such a service or not...

Finally, in terms of s 76:

'A municipality may provide a municipal service in its area or a part of its area through—

- (a) an internal mechanism, which may be—
 - (i) a department or other administrative unit within its administration;
 - (ii) any business unit devised by the municipality, provided it operates within the municipality's administration and under the control of the council in accordance with operational and performance criteria determined by the council; or
 - (iii) any other component of its administration; or
- (b) an external mechanism by entering into a service delivery agreement with—
 - (i) a municipal entity;
 - (ii) another municipality;
 - (iii) an organ of state...

[4] Section 5 of the ITA provides that income tax (normal tax) shall be payable in respect of the taxable income received by or accrued to or in favour of any person during the year of assessment or any company during every financial year of such company.³ Section 10 of the ITA is an exemption provision. It provides that certain specified receipts and accruals are exempt from normal tax. The list is a closed one, with the result that, unless specifically mentioned in s 10, the receipts and accruals are taxable in terms of s 5 of the ITA.

[5] Prior to 7 February 2007, ss 10(1)(a) and (b) of the ITA provided as follows:
‘There shall be exempt from normal tax:

- (a) the receipts and accruals of the Government, any provincial administration or of any other state;
- (b) the receipts and accruals of local authorities...’

Those provisions were amended by the Revenue Laws Amendment Act 20 of 2006. The words ‘of any other state’ in subsection (a) were deleted and the expression ‘local authorities’ in subsection (b) was replaced by the word ‘municipalities’. The subsections accordingly came to read:

- ‘(a) the receipts and accruals of the Government or any provincial administration;
- (b) the receipts and accruals of municipalities.’

[6] Following the amendment, the s 10(1)(b) exemption came to apply to ‘the receipts and accruals of municipalities’. The reasons for the amendment appear in an Explanatory Memorandum on the Revenue Laws Amendment Bill, 2006,⁴ issued by National Treasury. In this Memorandum, Treasury explains that ‘the Income Tax

³ See s 5(1)(c) and (d) of the Income Tax Act 58 of 1962 (ITA).

⁴ National Treasury *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2006* WP2 – 06.

Act contains various forms of exemption for different spheres of Government. National and provincial governments are fully exempt under s 10(1)(a).⁵ It added: ‘Certain institutions, boards and bodies subject to the Public Finance Management Act, 1999 (Act 1 of 1999) (PFMA) are exempt from income tax under s 10(1)(cA), along with their wholly owned subsidiaries. Municipalities receive exemption as a “local authority” under s 10(1)(b), but municipal entities that are subject to the Municipal Finance Management Act, 2000 (Act 32 of 2000) (MFMA) are fully taxable.’

[7] The reason advanced for the change was that: ‘[t]he Income Tax system fails to provide a coherent regime for Government entities’. According to Treasury:

‘The various references to local councils, boards and committees are outdated. The definition of local authority will accordingly be scrapped in line with the new system for local government as prescribed by the Local Government: Municipal Structures Act, 1998 (Act 117 of 1998). Henceforth, only “municipalities” (Categories A, B and C) will be exempt as opposed to “local authorities”. Collateral changes in this regard have already been made in the Value-Added Tax Act along with corresponding changes to the Transfer Duty Act.’⁶

[8] Section 10(1) of the ITA was amended once again, on 2 November 2010, by the Taxation Laws Amendment Act 7 of 2010. Subsection (1)(b) was deleted, while subsection (1)(a) was substituted by the following:

‘There shall be exempt from normal tax—

(a) the receipts and accruals of the government of the Republic in the national, provincial or local sphere...’

Thus, after 1 January 2011, City Power had to qualify as ‘the government of the Republic in the ... local sphere’ for it to be exempt from normal tax.

⁵ Ibid at 40.

⁶ Ibid.

[9] In terms of s 40(1) of the Constitution of the Republic of South Africa, 1996 (the Constitution), the Government of the Republic of South Africa is constituted as national, provincial and local spheres of government, which are distinctive, interdependent and interrelated.⁷ Chapter 7 of the Constitution provides, among other things, for the establishment of municipalities for the whole of the territory of the Republic. In terms of s 155(6) of the Constitution, each provincial government must establish municipalities in its province in a manner consistent with the legislation enacted in terms of s 155(2) and (3).⁸ Municipalities established throughout the territory of the Republic constitute the local sphere of government.⁹ The local sphere of government is structured as ‘(a) self-standing municipalities, (b) municipalities that form part of a comprehensive coordinating structure, and (c) municipalities that perform coordinating functions.’¹⁰

[10] As the Explanatory Memorandum to the Tax Law Amendment Bill, 2010¹¹ makes plain, ‘[t]he proposed amendment seeks to update the wording of the Income Tax Act in line with the current concept of the three spheres of government in the Constitution’.¹²

[11] ‘Municipality’ is defined in s 1 of the ITA as meaning:

⁷ *Democratic Alliance and Another v Masondo NO and Another* 2003 (2) SA 413 (CC) para 7.

⁸ Section 155(6) of the Constitution. Section 1 of the Local Government: Municipal Demarcation Act 27 of 1998 defines a municipality as ‘a municipality mentioned in s 155(6) of the Constitution and includes a municipality which existed when this Act took effect...’

⁹ Section 151(1) of the Constitution.

¹⁰ *Ex Parte Chairperson of the Constitutional Assembly: In re Certification of the Amended Text of the Constitution of the Republic of South Africa, 1996* 1997 (2) SA 97 (CC) para 77.

¹¹ National Treasury *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2010* WP – 10.

¹² *Ibid* at 104.

‘[a] municipality which is within a category listed in s 155(1) of the Constitution¹³ ... and which is an organ of state within the local sphere of government exercising legislative and executive authority within an area determined in terms of the Local Government: Municipal Demarcation Act, 1998 (Act 27 of 1998).¹⁴

City Power plainly did not qualify as a municipality as defined. That ought to be the end of the enquiry insofar as the s 10(1)(b) exemption is concerned. However, it was contended that the exemption found application because, in discharging the constitutional functions that the City was obliged to perform, City Power acted *qua* City. Accordingly, so the argument went, its receipts and accruals fell to be treated on the same footing as those of a municipality. What this contention boils down to is that City Power must, for all intents and purposes, be deemed to be a municipality, with the result that the s 10(1)(b) exemption applies. Although by no means persuaded, I shall assume in City Power’s favour that it is permissible to approach the enquiry in this fashion. For, it seems to me that even on this footing City Power fails to bring itself within the exemption.

[12] In this regard, *Income Tax Case No 327*¹⁵ is instructive. The Court had to there consider whether an individual who was employed by a Board that was established by and on behalf of Government is a ‘government employee’ for the purposes of qualifying for an exemption. It reasoned:

¹³ Section 155(1) of the Constitution provides:

‘There are the following categories of municipality:

- (a) Category A: A municipality that has exclusive municipal executive and legislative authority in its area.
- (b) Category B: A municipality that shares municipal executive and legislative authority in its area with a category C municipality within whose area it falls.
- (c) Category C: A municipality that has municipal executive and legislative authority in an area that includes more than one municipality.’

¹⁴ The definition of ‘municipality’ was inserted by Act 20 of 2006 and accords with s 2(a) of the Local Government: Municipal Systems Act 32 of 2000.

¹⁵ *Income Tax Case No 327* (1935) 8 SATC 254 (U) at 256-8.

‘Now, the letter of the Governor of the Colony does not appear to bear out the appellant's contention that he is a Government servant. The letter states that the Board is a body established by Statute; that its purpose is to foster the demand for the products of the Colony in the markets of the world; and that the Board has appointed appellant to act as Commissioner for the Union of South Africa. When we have regard to the terms of the Ordinance it appears to us that this is a body similar to bodies which have been created in recent times for the purpose of furthering the trade of a country in other countries. But the terms of the Ordinance do not indicate that the body in question is under the direct control of a Government department. It is free to act at its discretion, and the only question which raises any difficulty is regarding the levy and destination of the money. Its moneys are derived from the levy of a special export duty. That duty when recovered is paid direct to the Board monthly by the Principal Collector of Customs, and no part is credited to the general revenue of the Colony. That is a departure from the recognised and accepted way of dealing with Government revenue. The Board has a very general discretion, and what seems to be of great importance is the language which is used in the Ordinance with regard to the appointment of officers. ... In terms of the subsection the Board appoints, employs, etc, its own officers, and it decides the administration of its own affairs. Now, those words “its own” indicate in both cases that this is something entirely separate from the Government or any other authority in the Colony. In other words, although created by Statute like a great many non-government bodies are, and although it derives its funds under the subsection mentioned from the Collector of Customs by means of the levy mentioned, it is quite independent. It appoints its own employees and remunerates and controls its own officers. Now, the fact that it controls its own officers indicates that the officers are not subject to the ordinary control which is exercised over government officers of the Public or Civil Service in the ordinary sense of the term. It is an entirely independent control. It is true, as argued by the appellant, that if the Government is dissatisfied with the work of the Board, or in an extreme case, with the work of an individual officer, it may withhold the funds of the Board, and thus virtually terminate its existence, but those same powers would appear to belong to any body to which government funds are contributed, whether hospital or charitable institutions, or even private institutions. A government is under no obligation to continue to provide funds to an object whose proceedings it does not approve of. That, however, is not the test whether an

individual is in the employment of the Government. Here the appellant is appointed, employed, remunerated and controlled by the Board itself, and the Board is a totally independent body.’

[13] Those factors are present here. The City simply enjoys the ordinary powers of a shareholder over City Power. City Power has an independent Board of Directors (the Board), which is autonomous, exercises its powers independently and is enjoined to act in the interests of City Power. Its powers, as appear in City Power’s memorandum of incorporation, are wide and substantial; and are, crucially, in the nature of those ordinarily associated with private companies. The Board has the power, inter alia, to: purchase or acquire shares, debentures and every other kind or description of movables and immovables; apply for, purchase or by any other means acquire, transfer, protect, prolong or renew patents, patent rights, licences, trade-marks, concessions or any other rights and to deal with and alienate them; borrow money in accordance with policies and within the ambit of the authorisation of the Board of Directors; secure the payment of moneys borrowed in any manner, including the mortgaging and pledging of property and without detracting from the generality thereof, in particular by the issue of any kind of debenture stock, with or without security; lend money to any person or company; invest money in accordance with the investment policies approved by the directors; and to open and operate banking accounts.

[14] City Power may also form and have an interest in any company or companies, amalgamate with other companies and take part in the management, supervision and control of the business or operations of any similar company or business. It may also enter into partnerships. In terms of the Service Delivery Agreement concluded between City Power and the City on 1 September 2006, the services to be provided

by the former are electricity distribution services, which constitutes its core business. It may however undertake any business other than its core business, albeit with the City's consent, which consent shall not be unreasonably withheld.

[15] Moreover, Parts 5 and 6 of Chapter 8A of the Local Government: Municipal Systems Act 32 of 2000 (the Systems Act) contain a range of measures that are designed to ensure the independence of the Board. Section 93A(*b*) provides that the parent municipality of a municipal entity 'must allow the board of directors and chief executive officer of the municipal entity to fulfil their responsibilities'. Section 93E regulates the appointment of Directors of the Board and provides that the board of directors of a municipal entity must have the requisite range of expertise to effectively manage and guide the activities of the municipal entity. At least a third of the directors must be non-executive directors. In addition, the Chairperson of the Board must also be a non-executive director.¹⁶ Once appointed, it is then the duty of the Board to inter alia 'provide effective, transparent, accountable and coherent corporate governance and conduct effective oversight of the affairs of the municipal entity'.¹⁷ The Board must appoint a Chief Executive Officer (CEO) of the entity, who then reports to the Board.¹⁸

[16] The Local Government: Municipal Finance Management Act 56 of 2003 (MFMA) is also of relevance. Section 85(1) and (2) of the MFMA provides that:

'(1) A municipal entity must open and maintain at least one bank account in the name of the entity.

(2) All money received by a municipal entity must be paid into its bank account or accounts, and this must be done promptly and in accordance with any requirements that may be prescribed.'

¹⁶ Section 93E(1)(*a*)-(*c*) of the Local Government: Municipal Systems Act 32 of 2000 (the Systems Act).

¹⁷ Section 93H(1)(*a*) of the Systems Act.

¹⁸ Section 93J of the Systems Act.

The bank account must be administered by the accounting officer (the CEO), who is accountable to the Board for the entity's bank accounts.¹⁹ As such, the fact that City Power might have agreed, through a service level agreement, to grant the City access to its accounts, does not change the fact that any decision over that bank account is exercised solely by the Accounting Officer and the Board.

[17] City Power's formation is explained in a letter to SARS dated 24 February 2014. It stated that the City housed municipal entities in separately registered companies from 2001 for various reasons, some of which include the attraction of quality top management to create efficiency in the City and its municipal entities, for business and commercial reasons and to create better ownership. The business was to be run along commercial lines, its object being to generate profit in the course of distributing electricity. There appears to be no restriction on City Power generating a profit. The effect of creating a private company for purposes of performing the functions of electricity distribution is that the receipts and accruals are those of the company, whereas in instances where the City itself directly distributes electricity (ie after purchasing in bulk from Eskom for downstream on-selling to consumers within its geographical jurisdiction), the receipts and accruals in relation to the supply of electricity would fall into the general funds of the municipality.

[18] It is not in dispute that the income from the supply of electricity by City Power is the income of City Power, notwithstanding that the City may have access to such monies. Such income is reflected in City Power's financial statement. The funds thus

¹⁹ Section 85(5) of the Systems Act.

accrued to City Power.²⁰ What it decides to do with such funds at a later stage does not change its character.²¹

[19] I turn to consider whether City Power falls within the concept of the ‘local sphere of government’. In *Independent Electoral Commission v Langeberg Municipality*,²² the Constitutional Court explained that a ‘sphere of government’ is a clearly defined concept and does not necessarily include an organ of state which performs a function that would ordinarily have been performed by the government. It held:

‘In this broad sense, the Commission does perform a governmental function. More specifically, it implements national legislation concerning the conduct of elections. ... That does not mean, however, that the Commission falls within the national sphere of government as contemplated by chapter 3 of the Constitution.’²³

[20] In that matter, the Constitutional Court concluded:

‘The Commission has tried to make some point of the fact that the conduct of the election falls within the national legislative authority of Parliament, contending that this is a factor which points to the Commission being part of the national sphere of government. This is an oversimplification. ... The Commission is clearly a State structure. The fact that a State structure has to perform its functions in accordance with national legislation does not mean that it falls within the national sphere of government.’²⁴

[21] In a similar vein, in *Minister of Home Affairs and Another v Public Protector*, this court held that the Office of the Public Protector is ‘not a department of state or

²⁰ *Commissioner for Inland Revenue v Cactus Investments (Pty) Ltd* 60 SATC 141 at 152.

²¹ *Commissioner for Inland Revenue v Witwatersrand Association of Racing Clubs* 1960 (3) SA 291 (A) at 180.

²² *Independent Electoral Commission v Langeberg Municipality* [ZACC 23] 2001 (3) SA 925 (CC) (*Langeberg Municipality*) paras 22, 27 and 29-31.

²³ *Ibid* para 24. (Footnotes omitted.)

²⁴ *Ibid* para 30.

administration and neither can it be said to be part of the national, provincial or local spheres of government'.²⁵ With reference to s 239 of the Constitution,²⁶ Plasket AJA stated:

'It is therefore not an organ of state as contemplated by subsection (a) of the definition. It is, however, an institution that exercises both constitutional powers and public powers in terms of legislation. It is, consequently, an organ of state as contemplated by subsection (b) of the definition.'²⁷

[22] These considerations apply equally to City Power. It is not part of the local sphere of government and is thus not located within such sphere. The mere fact that it performs constitutional functions, which would ordinarily have been performed by the City, does not mean that it is part of or located within the local sphere of government.

[23] The appellant relies on *Grinpal*²⁸ and *Joseph*²⁹ and contends that in those judgments, the Constitutional Court 'characterised City Power through its functions'. The appellant's reliance on these judgments is, however, misplaced. Those judgments merely reiterated a trite principle, namely that City Power performs

²⁵ *Minister of Home Affairs and Another v Public Protector* [2018] ZASCA 15; 2018 (3) SA 380 (SCA) para 34. (Footnotes omitted.)

²⁶ Section 239 of the Constitution defines 'organ of state' to mean:

'(a) any department of state or administration in the national, provincial or local sphere of government; or
(b) any other functionary or institution—
(i) exercising a power or performing a function in terms of the Constitution or a provincial constitution; or
(ii) exercising a public power or performing a public function in terms of any legislation, but does not include a court or a judicial officer.'

²⁷ *Minister of Home Affairs* (above fn 25) para 34.

²⁸ *City Power (Pty) Ltd v Grinpal Energy Management Services (Pty) Ltd and Others* [2015] ZACC 8; 2015 (6) BCLR 660 (CC).

²⁹ *Joseph and Others v City of Johannesburg and Others* [2009] ZACC 30; 2010 (4) SA 55 (CC).

a public function.³⁰ That much is not in dispute. *Grinpal* and *Joseph* do not state that simply because City Power performs a public function it falls within the local sphere of government. Nor does *Allpay*.³¹

[24] The *ratio* in *Grinpal* appears at para 23, whereafter the court stated that, ‘[h]aving found that City Power is a municipal entity governed by [the Systems Act] and that *Grinpal* is an organ of state, the next question is whether s 197 of the [Labour Relations Act 66 of 1995] is applicable to both entities’.³² It then proceeded to find that s 197 applies to City Power.³³ That, however, is a far cry from finding that City Power is located within the local sphere of government. Significantly, the Constitutional Court observed that City Power performs public functions ‘akin to those of a municipality’.³⁴

[25] The same can be said of *Joseph* and *Allpay 2*. In *Joseph* the Constitutional Court was concerned with the question of whether City Power was performing a public or a private function when providing electricity to the residents of Ennerdale Mansions. It found that it was performing a public function and that public-law duties, such as the duty of procedural fairness, thus applied to City Power.³⁵ Similarly, in *Allpay 2* the Constitutional Court was dealing with the question whether Cash Paymaster was performing a public function and was thus bound by the Constitution. Importantly, it held that ‘[i]n our constitutional structure, [the entity]

³⁰ This principle had already been confirmed by the Constitutional Court in *AAA Investments (Pty) Ltd v Micro Finance Regulatory Council and Another* [2006] ZACC 9; 2007 (1) SA 343 (CC) at paras 40-43 (Yacoob J) and 119 (O’Regan J).

³¹ *Allpay Consolidated Investment Holdings (Pty) Ltd and Others v Chief Executive Officer of the South African Social Security Agency and Others (No 2)* [2014] ZACC 12; 2014 (4) SA 179 (CC) (*Allpay 2*).

³² *Grinpal* (above fn 28) para 24.

³³ *Ibid* para 34.

³⁴ *Ibid* para 23.

³⁵ *Joseph* (above fn 29) para 46.

... does not have to be part of government or the government itself to be bound by the Constitution as a whole'.³⁶

[26] There is accordingly no merit in the suggestion that City Power falls within the local sphere of government. As the receipts and accruals of City Power are not those of 'the government of the Republic' in any of the spheres (ie the national, provincial or local spheres), and were at no stage the 'receipts and accruals of municipalities', the s 10(1)(a) and 10(1)(b) exemptions do not apply in respect of the income in issue.

[27] It follows that the appeal must fail. In the result:
The appeal is dismissed with costs, including those of two counsel.

V M Ponnann
Judge of Appeal

³⁶ *Allpay 2* (above fn 31) para 53, referring to the dictum of Yacoob J in *AAA Investments* (above fn 30) para 41.

APPEARANCES

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