MP Finance Group CC (In Liquidation) v C: SARS: Adding to the financial hardship of victims of illegal transactions

J.M.P. Venter, W.R. Uys & M.C. van Dyk

ABSTRACT

This article analyses the interpretation of the phrase "received by, accrued to or in favour of" in the gross income definition of the Income Tax Act, as applied to illegal receipts. During the last few decades, South Africans have been victims of a number of Ponzi-type schemes. In *MP Finance*,[1] the Supreme Court of Appeal considered whether illegal receipts received by the Krion Ponzi-type scheme should be included in gross income. After considering the relationship between the taxpayer and the *fiscus*, the court concluded that, as from a specified juncture, the taxpayer received the amount for its own benefit and it should therefore be included in gross income.

The court recognised that the contractual relationship between the investor and the scheme (taxpayer) could in fact be void, resulting in the investor having a right to recover the investment from the taxpayer. The court did not consider whether the levying of income tax on amounts received by the operator of the scheme could infringe on the investor's right to property espoused under the Constitution of the Republic of South Africa, 1996. It is submitted that the levying of tax does infringe on this right as it reduces the amount that could be recovered from the scheme because the original investment in the scheme is void.

Key words: gross income definition of the Income Tax Act; "received by, accrued to or in favour of"; received for own benefit; Krion Ponzi-type scheme; illegal receipts; MP Finance Group; right to property

---

Prof J.M.P. Venter is in the Department of Financial Intelligence, University of South Africa. Mr W.R. Uys and Mr M.C. van Dyk are in the Department of Taxation, University of South Africa. E-mail: ventejmp@unisa.ac.za; uyswr@unisa.ac.za; vdykmc@unisa.ac.za

1 *MP Finance Group CC (In Liquidation) v C:SARS*, 69 SATC 141.

On 14 October 2010, in the High Court in Pretoria, one of the largest fraud cases in South African history approached its culmination and finalisation, following an eight-year legal process. Mrs Marietjie Prinsloo of Vanderbijlpark, an industrial town south-west of Johannesburg, and six members of her extended family (facing 218 683 charges, including fraud, theft, racketeering and money laundering) were convicted and sentenced to jail terms.[2] Prinsloo received a 25-year jail sentence, and her family members received sentences ranging from five to 15 years.[3]

After the collapse of Prinsloo's Ponzi-type scheme[4] in 2002, and her subsequent arrest in the same year, the criminal case against her had garnered national media coverage. It was a subject of intense speculation and conjecture: how had a middle-aged wife and mother, with a standard 8 (grade 10) qualification and no previous criminal record managed in the space of five years – after starting a micro-lending business from her home in 1997 – to build a R1.5 billion illegal Ponzi-type scheme.[5] An estimated R908 million of investors' money had vanished.[6] Most of the approximately 14 000 investors in the scheme were financially ruined, losing their pensions, life savings, retrenchment packages and homes.[7] Local churches and schools in the Vanderbijlpark area started feeding schemes and distributed subsistence packages to the victims.[8] Cases of counselling and treatment for depression increased markedly in the area,[9], and the suicide of at least one investor has been directly linked to the implosion of the scheme.[10]

The legal ramifications of Prinsloo's fraudulent scheme went beyond the criminal case heard in Pretoria, however. Three years before the High Court reached its decision, judgment in a separate and related case was handed down in Bloemfontein. This case was less publicised but dealt with taxation: specifically the taxation of Prinsloo's criminal enterprises. The case heard in Bloemfontein (*MP Finance Group*

2 *State v Prinsloo and Others*, [2010] ZAGPPHC at 117.2
3 *Supra* at 117.
4 Ponzi and pyramid schemes are fraudulent investment programmes promising high rates of return to investors. The Ponzi scam is named after Charles Ponzi, who orchestrated the first such scheme in 1919. Both schemes pay early investors returns from money received from later investors. See Skalak, S.L., Lau, R. and Clarke, S. 2011. A Guide to Forensic Accounting Investigation, 2nd edition: Chapter 24. New Jersey: John Wiley and Sons; Investopedia 2013.
5 *State v Prinsloo and Others*, [2010] ZAGPPHC at 58.
6 *Supra* at 58.
7 *Supra* at 58.
8 *Supra* at 49.
9 *Supra* at 49.
10 Smith, D. 2002. Braving the Social Consequences of Fraud. *Independent Online*, Volume 28, June 2002. [Online] Available at: http://www.iol.co.za/news/south-africa/braving-the-social-consequences-of-fraud-1.88850 (Accessed: 12 August 2013).

CC [In Liquidation] v:[11] *[hereafter MP Finance]*) was, in its own way, highly significant and is a landmark in South African tax case law. For the first time in this country's legal history, a case involving the taxation of illegal income had been heard by the Supreme Court of Appeal.

For ease of administration, the liquidators of Prinsloo's various enterprises, both incorporated and unincorporated, had consolidated them into one entity: MP Finance Group CC.[12] It was on this entity that the South African Revenue Service (SARS) raised three separate income tax assessments, for the years 2000 to 2002. The liquidators, representing the approximately 14 000 investors, contested these assessments and took the matter to the Natal Tax Court.[13] When that court did not find in their favour, the case was taken to the Supreme Court of Appeal. The liquidator's persistence is not surprising. It is estimated that the tax assessments, in total, amounted to almost R500 million.[14] If the liquidators lost the case, it effectively meant there was that much less to pay out to the investors – and in fact, it would mean that the investors would receive virtually nothing back.

Guidance can be found in the previous decisions by not only the South African judiciary but also foreign judiciaries. According to the judges in the United States' *Glenshaw Glass*[15] case, there are two fundamental principles of income tax: the first being that "the Code" (the Income Tax Act) is the decisive basis of tax law and, secondly, that the term "gross income" is the *single most important definition* that underpins every single realisation of wealth, irrespective of its source. The Supreme Court of Appeal did not deviate from these principles in *MP Finance*. The point the Supreme Court of Appeal had to consider was whether the amount had accrued to the taxpayer or whether it had been received for the taxpayer's benefit.[16]

Although the issues before the court concerned the application of the provisions of the Income Tax Act, the decision in the case should be reconsidered in the light of the provisions of the Constitution of the Republic of South Africa, 1996 ("the Constitution").

---

11 (2007) 69 SATC 141.

12 The original scheme was also known as the Krion Pyramid Investment Scheme, *Janse van Rensburg NO and Others v Steyn*, [2011] ZASCA 71.

13 *ITC* 1789, (2005) 67 SATC 205.

14 Olivier, L.O. 2008. "The Taxability of Illegal Income". *TSAR* at 817.

15 *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955).

16 Section 1 of the Income Tax Act No. 58 of 1962.

Background to and facts of the case

Prinsloo's Ponzi-type scheme left a trail of economic and financial devastation in its wake. Three-quarters of the "investors" were over the age of 40 and almost 30% were between the ages of 50 and 97 years, indicating that the pensions and retrenchment packages of many had been lost.[17] In addition, many lost their houses, resulting in their having to live in backyard rooms, garages or makeshift shacks.[18] The collapse of the scheme also had severe implications for the local community, which had to provide financial, emotional and practical support to the victims. A social worker reported that the town would probably take decades to fully recover – possibly only once all the scheme's victims were no longer alive.[19]

The investors, however, had not always been faced with financial ruin – at least not in the first few years of the scheme. Gullible participants had been informed that they were investing in a micro-lending business and were being paid out "dividends" and "interest". In reality, they were simply being paid a portion of the contributions from newer investors. As is typical of most Ponzi schemes,[20] early participants received substantial returns. Prinsloo was offering – and paying out – returns of 8% to 10% *per month*.[21] That amounted to returns often exceeding 100% on an annualised basis – roughly ten times the going rate available from a commercial bank at that time.[22]

While matters went well for the scheme and its investors, Prinsloo became known as "the Angel of Vanderbijlpark" – a reference to the financial "help" she was offering the people of the town.[23] At that time, many of the town's residents were, in fact, living in straitened circumstances and needed financial help. Vanderbijlpark was in the midst of a serious and long-term industrial slump, and it could be argued that the rapid rise of Prinsloo's scheme in the late 1990s was inversely related to the economic fortunes of the town.

Vanderbijlpark owes its establishment to one thing, and one thing only: steel.[24] In 1941, in the midst of the Second World War, a site for a new, large, South African

---

17 *State v Prinsloo and Others*, [2010] ZAGPPHC at 42.

18 SAPA. 2010. Vaal still Feeling Krion Fallout. [Online] Available at: http://www.news24.com/SouthAfrica/News/Vaal-still-feeling-Krion-fallout-20101006 (Accessed: 12 August 2013).

19 *Supra*.

20 Skalak, S.L., Lau, R. and Clarke, S. 2011. *A Guide to Forensic Accounting Investigation*, 2nd edition: Chapter 24. New Jersey: John Wiley & Sons.

21 Kühne, I. 2002. Prinsloo se Foon Fuis van die Dreigoproepe. *Rapport*, Volume 1, June 2002. [Online] Available at: http://www.rapport.co.za/Suid-Afrika/Nuus/Prinsloo-se-foon-suis-van-die-dreigoproepe-20020601 (Accessed: 12 August 2013).

22 South African Reserve Bank. 2013. Selected historical exchange rates and other interest rates. [Online] Available at: http://www.resbank.co.za/Research/Rates/Pages/SelectedHistoricalExchangeAndInterestRates. aspx [Accessed: 31 May 2013].

23 *State v Prinsloo and Others* [2010] ZAGPPHC at 50.

24 Vaal Triangle Information. 2013. Vaal Triangle History. [Online] Available at: http://www.vaaltriangleinfo.co.za/history/overview/overview4.htm (Accessed: 31 May 2013).

steelworks was sought and found on grassy farmland along the Vaal River, west of Vereeniging. The site had much in its favour: there was unlimited room for expansion, the gently sloping terrain allowed for sufficient drainage down to the river, relatively high open ground meant that prevailing winds would minimise pollution in the area, and the site was downstream from the purification plant that supplied the Witwatersrand's water needs.

The person responsible for choosing the site was one Hendrik Johannes van der Bijl. A brilliant scholar, educated in Stellenbosch and Germany, Van der Bijl had, by the age of 25, begun a stellar career as a scientist and inventor in the United States. Seven years later, the 32-year-old Van der Bijl – handpicked by the then Prime Minister, General Smuts – returned to his homeland in 1920 in the capacity of technical advisor to the South African Government. Within eight years of returning, Van der Bijl had been appointed first chairman of not only the newly created Electricity Supply Commission (Escom), but also the Iron and Steel Corporation (ISCOR). It was in his capacity as chairman of ISCOR that Van der Bijl identified and approved the steelwork's site near the Vaal River.[25]

Once the location for the steelworks had been selected, plans were put in place to develop and establish an independent town alongside it. In 1943, the town of Vanderbijlpark came into being.[26] The town was intended to be "a modern garden city and a modern industrial town in such a way as will most effectively promote all possible amenities, conveniences and benefits for, and the general welfare and well-being of, the inhabitants".[27] More than half a million trees were planted in order to transform the town and surrounding area into the "Hyde Park" of South Africa.[28]

In the decades following the Second World War both the steelworks and town grew and prospered. In 1989, ISCOR was fully privatised following its listing on the Johannesburg Stock Exchange.[29] Five years later, South Africa's political and economic isolation ended following the country's first democratic election.[30]

It was during the 1990s – half a century after the founding of Vanderbijlpark – that the fortunes of the steel industry took a turn for the worse. International steel

---

25 South African History Online. 2013. Dr Hendrik Johannes van der Bijl. [Online] Available at: http://www.sahistory.org.za/dated-event/dr-hendrik-johannes-van-der-bijl-sa-industrialist-who-laid-foundation-establishment-esco (Accessed: 7 August 2013).

26 Van Wyk, A. 1991. Vaal Triangle: A Region of Growth and Prosperity. Randburg: Target Communications.

27 *Supra* at 24.

28 *Supra* at 25.

29 ArcelorMittal South Africa. 2013. Company history. [Online] Available at: http://www.arcelormittalsa.com/Company/History.aspx (Accessed: 7 August 2013).

30 Department of Government Communication and Information Services. 2012. *South Africa Yearbook 2011/2012*. [Online] Available at: http://www.gcis.gov.za/content/resourcecentre/sa-info/yearbook2011-12 (Accessed: 7 August 2013).

prices entered a downward trend for a variety of reasons; excess production capacity and rising international competition following the fall of the Soviet Union, were two significant contributing factors.[31] The South African steel industry was not left unaffected. Employment in the sector declined from 54 000 in 1990 to 24 000 in 2000[32] – many of those job losses occurring at the Vanderbijlpark plant, where blast furnaces and strip mills were decommissioned.[33]

It was against this background of large-scale layoffs, unemployment and financial hardship in the late 1990s that Marietjie Prinsloo, from her suburban Vanderbijlpark home, started what was ostensibly a micro-loan lending business, offering naïve and unsophisticated investors – many recently retrenched – huge returns. It is in some ways not surprising that her scheme lured so many victims, given the parlous state in which a significant portion of the town's residents found themselves.

Ponzi schemes inevitably unravel when the required number of new contributors cannot be found to pay out existing investors.[34] At the beginning of May 2002, pay-outs to investors had become sporadic.[35] By the end of that month, the pay-outs had stopped.[36] Prinsloo's various entities were placed under provisional liquidation the following month.[37] In July 2002, the police's commercial branch and Serious Economic Offences Unit arrested her and other members of her family. The arrestees spent four nights in a jail cell until being released on bail for a combined amount of R45 000.[38] They were to remain free on bail until the High Court hearing, some eight years later.

In that 2010 hearing, the astonishing raft of charges that Prinsloo, alone, was convicted of, provides an indication of the gravity of the case against her: contravention of the Prevention of Organised Crime Act[39] (13 convictions); fraud (31 215 convictions);

---

31 Firoz, A.S. 2003. "Steel Industry in Turmoil: Structural Crisis of 1990s". *Economic and Political Weekly* Volume 38, No. 15 at 1493-1504.

32 Tyrer, L. 2007. "Steel Exports Fuel SA's Production Growth". [Online] Available at: http://www.engineeringnews.co.za/print-version/steel-exports-fuel-sa039s-production-growth-2007-07-13 (Accessed: 14 August 2013).

33 Coakley, G.J. 1998. "The Mineral Industry of South Africa". *U.S. Geological Survey Minerals Yearbook* 1998. [Online] Available at: http://minerals.usgs.gov/minerals/pubs/country/1998/9235098.pdf (Accessed: 14 August 2013).

34 Van Doesten, J. 2010. Tax Implications of Ponzi Schemes. *The Taxpayer*, Volume 6: Cape Town.

35 Tempelhoff, E. 2002a. Skemavrese in Vaaldriehoek. *Beeld*, Volume 21, May 2002. [Online] Available at: http://152.111.1.88/argief/berigte/beeld/2002/05/21/6/13.html (Accessed: 13 August 2013).

36 Kuhne, I. 2002. Prinsloo se Foon Suis van die Dreigoproepe. *Rapport*, Volume 1, June 2002. [Online] Available at: http://www.rapport.co.za/Suid-Afrika/Nuus/Prinsloo-se-foon-suis-van-die-dreigoproepe-20020601 (Accessed: 12 August 2013).

37 Mulder, N. 2002. Krion Voorlopig Gelikwideer ná 'Piramide-bedrywighede'. *Beeld*, Volume 6, June 2002. [Online] Available at: http://152.111.1.88/argief/berigte/beeld/2002/06/06/5/6.html (Accessed: 13 August 2013).

38 Tempelhoff, E. 2002b. Krion-6 uit Selle, Weer Gegryp (2002) *Beeld*, Volume *27*, July 2002. [Online] Available at: http://152.111.1.88/argief/berigte/beeld/2002/07/27/1/2.html (Accessed: 13 August 2013).

39 Act No. 121 of 1998.

contraventions of the Bank Act[40] (57 277 convictions); contravention of the Insolvency Act[41] (3 convictions); contravention of the Co-operative Banks Act[42] (9 070 convictions); contravention of the Income Tax Act[43] (2 039 convictions); theft (816 convictions); contravention of the Close Corporation Act[44] (1 conviction); contravention of the Companies Act[45] (3 convictions); and conducting harmful business practices[46] (17 972 convictions).[47] Each of these convictions brought separate sentences ranging from six months to 20 years – the vast majority being served concurrently – resulting in an effective jail term for her of 25 years. The sentences in aggregate are astounding, however, amounting to a total period in excess of 29 000 years.[48]

A case of this magnitude does not go unnoticed. Following the collapse of the scheme in 2002, Prinsloo's various entities became the subject of a SARS investigation. That investigation led to assessments for a single, consolidated entity in the process of liquidation: *MP Finance Group CC*.[49] The assessments covered a three-year period, from 2000 to 2002, and reportedly amounted to just under R500 million. The quantum of those assessments made it inevitable that the liquidators, representing thousands of investors, would contest them.

The fact that *MP Finance Group CC* had generated its income illegally was not a matter of dispute. What was disputed was whether that fraudulently derived income could be subject to taxation.[50] The South African Income Tax Act[51] makes no specific reference to illegal income. Hence when the case went to court, both plaintiff and appellant had to rely on a precise interpretation of the Act's wording and the precedent offered by the relatively sparse case law that had, in the past, dealt with this issue.

Legal precedent: Illegal receipts

The first legal dispute in South Africa regarding the issue of whether or not illegal receipts are taxable occurred almost a century ago. In the subsequent decades leading up to *MP Finance* in 2010, a relatively small body of case law – not always entirely

40 Act No. 94 of 1990.
41 Act No. 24 of 1936.
42 Act No. 40 of 2007.
43 Act No. 58 of 1962.
44 Act No. 69 of 1984.
45 Act No. 61 of 1973.
46 Consumer Affairs Act, 71 of 1988.
47 *State v Prinsloo and Others*, [2010] ZAGPPHC at 43.
48 *Supra* at 117.
49 *Janse van Rensburg NO v Steyn*, [2011] ZASCA 71.
50 Income Tax Act No. 58 of 1962: Section 1: "Gross income" definition.
51 No. 58 of 1962.

consistent – had developed around this issue. The significance of *MP Finance* lies in the fact that, decades after the issue had first been raised in our courts, the South African Supreme Court of Appeal was finally called upon to bring some clarity and finality to the question of whether illegal receipts are in fact taxable.

The argument that the illegality of a business precludes the South African state from taxing the profits of that business was first mooted in *CIR v Delagoa Bay Cigarette Co Ltd*[52] in 1918. Delagoa Bay Cigarette Co Ltd sold packets of cigarettes worth sixpence for ten shillings. Each packet sold included a coupon with a lucky number. An advertisement was placed on each coupon stating that two-thirds of the income received would be distributed as prizes. Winning voucher numbers were advertised and the distributed prizes ranged from £2 000 to £2. After paying two distributions, the company was successfully prosecuted for running an illegal lottery. The court had to decide if the income earned from this illegal transaction could be subject to income tax.

Relying on the precedent of English case law, the court found that the legality or illegality of a business was irrelevant to the issue of whether income is subject to taxation. The South African Income Tax Act makes no reference to the taxation of illegal income and, as a result, the starting point for determining whether any amount, legal or illegal, will be subject to tax is the Income Tax Act's "gross income" definition.[53] If a particular receipt – legal or otherwise – does not comply with that definition it cannot, apart from the application of capital gains tax, be subject to income tax.

The core definition of what constitutes "gross income" has remained virtually unchanged since the introduction of the principal Income Tax Act in South Africa in 1914. The current definition reads as follows: "*… the total amount, in cash or otherwise, received by or accrued to or in favour of such resident; during such year or period of assessment, excluding receipts or accruals of a capital nature*, …".[54] Most elements of the definition are self-evidently not in dispute when the taxation of illegal income has been contested. Legal arguments in the context of illegal income have largely hinged – and with good reason – on one section of the gross income definition: the "received by" portion.

When it comes to illegal income, there should be no question of "accrual". Accruals involve amounts that have not yet been received – a situation that does not apply to most cases of illegal income, as the income is already in the criminal's

52 (1918) 32 SATC 47.
53 Income Tax Act No. 58 of 1962: Section 1: "Gross income" definition.
54 *Supra*.

possession. "Accrual", furthermore, implies a legal entitlement which a thief can never have.[55] The issue of "receipt", however, has been reported to be the crux of most cases dealing with the taxation of illegal income. The recurring question raised in our courts is: can cash or belongings, illegally obtained, truly be "received" by a felon, in terms of the requirements of the definition of "gross income" in the Income Tax Act; and, if so, can that receipt then be subject to tax?

At the outset, it is important to be aware that one issue in the "received by" debate has never seriously been contested by either taxpayer or SARS: the word "received", as used in the Income Tax Act, cannot – and was never intended to – be given its widest, everyday meaning. It has been pointed out, for example, that a farmer who borrows a tractor has, in the ordinary sense of the word, "received" it. Likewise, a person who borrows money from a bank has, in normal usage, "received" the money. But this is not the interpretation to be placed on the wording in the Income Tax Act definition. As soon as an object or an amount of money is borrowed, a corresponding obligation arises to return the item or repay the amount. What has been borrowed can never rightfully be said to belong to the borrower, and for the purposes of taxation, has not been "received".[56]

If "received" should not be given its broadest meaning, the question arises: What should the word mean, for income tax purposes? One interpretation is that "received by" must mean "received by the taxpayer *on his own behalf for his own benefit*" (emphasis added).[57] In terms of this interpretation, an agent collecting rentals on behalf of a client will not have "received" the income because it is not received on his or her behalf or for his or her own benefit. Physical control over money or items that can be turned into money does not therefore necessarily mean that "receipt" has taken place.[58] The courts' interpretation of "received by" in cases dealing with "receipt" was not, however, within the context of illegal income.

In cases prior to *MP Finance*, where the taxation of illegal income had been disputed, the arguments of taxpayers and SARS had followed various strands. In *COT v G*, it was argued, on behalf of a taxpayer, that the word "received" should be given its ordinary dictionary definition.[59] The taxpayer was employed by the government and his duties included the management of money for specific projects and tasks. During his period of employment, he managed to steal approximately $58 000 of the funds under his control. After being caught, he was convicted of theft with part of his prison sentence suspended on condition that he repaid the stolen money.

---

55 Lategan v CIR, (2 SATC 16).
56 *CIR v Genn*, (20 SATC 113) at 122.
57 *Geldenhuys v CIR*, (14 SATC 419).
58 *Supra* at 33.
59 See *COT v G*, (43 SATC 159) at 161.

The taxpayer succeeded in his argument that the definition of "received" indicates that the acts of giving and receiving are inextricably linked. In other words, in order for there to be a receiver, there must be a giver. When it comes to theft, property is patently never given – it is taken. And if it is not given it has not been "received", and is therefore not taxable.[60] Stein submits that stolen money is analogous to borrowed money.[61] This argument is based on the subjective presumption that stolen money or property can never belong to or become the property of a thief. It, like borrowed money, is only received by the felon in the broadest sense of the term; and the moment possession is taken of the stolen item, an obligation immediately arises to repay or return it. The criminal cannot therefore be said to have "received" the money in the way in which the term is used in the "gross income" definition.

Not all illegal income, however, arises as a result of outright theft. Illegal schemes often involve willing participants handing over their money. In other words, there is no unilateral taking and, as a result, the line of argument pursued by the taxpayer in *COT vs G*[62] is not always necessarily valid. A taxpayer[63] who bought and sold stolen diamonds and operated an illegal "milk culture" scheme, in terms of the scheme members of the public acted as "growers". The investor would buy "activators" from the company which were then used to grow the milk cultures ("crops"). After a specific period, the crops would be harvested and the crops would then be sold back to the company. The proceeds could then be withdrawn or used to buy more "activators".

The taxpayer could not argue that the money had been received from unwilling participants and accordingly had followed a different line of argument.[64] His counsel's contention was that the scheme was, from the outset, void. As a direct result of that invalidity, the taxpayer had no right to the income and the amounts involved could not therefore have been "received by or accrued to or in favour of" him. The court, however, disagreed. It found that all consequences flowing from void contracts could not be ignored. The taxpayer had received the income on his own behalf and for his own benefit. The fact that the scheme had no legal substance did not alter that fact. As far as the court was concerned, there was "no reason for holding that such an amount is not 'received' within the definition of gross income in section 1, if that word is to be given its ordinary literal meaning".[65]

---

60 Stein, M. 1998. Tax the Fruit of Fraud: The Tale of Two Cases. *Tax Planning Journal*, Volume 12(5) at 114–116.
61 *Supra*.
62 *Supra*.
63 *ITC* 1545, (54 SATC 464).
64 *Supra*.
65 *Supra* at 467.

The issue of whether an amount has been received on behalf of a taxpayer and for his or her benefit is, however, not necessarily clear-cut. In one case, a stockbroker, acting as an agent, generated secret profits by manipulating various share transactions at his client's expense.[66] The issue before the court was whether those secret profits were taxable in the hands of the stockbroker. The court found that even though the taxpayer's subjective intention was to benefit from those profits, in terms of the law of agency, he had not legally "received" the income in his own right and for his own benefit. As a result, the court found that the secret profits did not fulfil the requirements of the gross income definition and, accordingly, were not taxable in the hands of the stockbroker.

Some of the legal arguments referred to above – raised over a period spanning some 80 years – were again employed, although with certain nuanced differences, when the *MP Finance* case went to the Natal Tax Court in 2005 and, two years later, on to the Supreme Court of Appeal.[67]

Legal precedent created by MP Finance

Although various cases have considered the principles governing illegal receipts, none of these cases were heard by the Supreme Court of Appeal,[68] which has the ability to create new rulings that are binding on all lower courts.

During the lower court judgment,[69] Judge Levinson was of the view that the investor deposits received by MP Finance CC were "receipts"[70] and fell within the ambit of the Income Tax Act[71] – notwithstanding the fact that the Krion Ponzi-type scheme was itself illegal, as were all the investors' transactions in the scheme. On appeal, the applicant argued that the taxpayer was liable in law to refund the deposits she had taken from investors, meaning that the investment amounts or "deposits" fell outside the ambit of "receipts", and consequently, the scope of the definition of "gross income" in the Income Tax Act.

---

66 *ITC* 1792, (67 SATC 236).

67 Goldswain, G.K. 2008. Illegal Activities: Taxability of its Proceeds. *Tax Planning Journal*. Volume 22 at 142; Muller, E. 2007. The Taxation of Illegal Receipts. A Pyramid of Problems: A Discussion on ITC 1789. *Obiter*, Volume 28(1) at166–181.

68 Previously known as the Appellant division.

69 *ITC* 1789 (67 SATC 205).

70 Income Tax Act No. 58 of 1962: Section 1: "Gross income" definition.

71 Classen, L.G. 2007. Legality and Income Tax: Is SARS Entitled to Levy Income Tax on Illegal Amounts Received by a Taxpayer? *SA Mercantile Law Journal*, Volume 19 at 534.

According to the court, an illegal contract can have consequences, including fiscal ones.[72] The question whether a valid contract was entered into between the investor and the scheme, is one of fact. If a valid contract was entered into between the parties, obligations will arise. The investor, who is the creditor, is entitled to claim performance from the scheme. Assuming that a valid contract existed, the investor may cancel the contract owing to misrepresentation on the part of the scheme. An investor would similarly have another remedy available – in the form of an undue enrichment claim.[73] It is suggested that a *bona fide* investor cannot enter into a valid contract when investing in a Ponzi scheme.

Interestingly, the court stated that although the relationship between investor and scheme was considered in the liquation proceedings,[74] it should not be considered when considering the taxability of an amount[75] – only the relationship between the scheme and *fiscus* should be taken into account. In a unanimous decision, Judge President Howie[76] found that although the amounts received were immediately repayable in law, they still constituted receipts.[77] The court found that because *MP Finance* knew that the scheme was insolvent and it would not be able to repay the money it received, its intention was to retain the money for its own use. Consequently, the taxpayer was operating a scheme of profit making,[78] and the amount received was included in gross income.

Constitutional right to property

The court's decision raises a key issue in relation to the investors' constitutional right to property. The decision of the court may have adversely affected the investors' right to property[79] as espoused in the Bill of Rights,[80] when considering the consequences of illegal contracts between subjects of law. It is suggested that the court's finding results in the right to claim property, lost as a result of an illegal contract, being secondary to the right of the *fiscus*.

---

72 Although the judges in these cases did not refer to foreign judgment, section 39 of the Bill of Rights in the Constitution of South Africa, 1996, states that the courts may consider foreign law as applied in foreign judgments. In this case, the court could have followed the judgment by the Canadian court in *Johnson v The Queen* 2011 TCC 540t.

73 Hutchison, D., Pretorius, C., Du Plessis, J., Hawthorne, L., Kuschke, B., Maxwell, C., Naude, T., and De Stadler, E. 2013. The Law of Contract in South Africa, 2nd edition. Cape Town: Oxford University Press.

74 *Fourie NO and Others v Edeling NO and Others*, 2004 ZASCA 28.

75 *MP Finance* at par 12.

76 Concurring: Nugent JA, Lewis JA, Van Heerden JA, Snyders AJA.

77 Income Tax Act No. 58 of 1962: Section 1: "Gross income" definition.

78 *Californian Copper Syndicate v Harris*, 5 TC at 166.

79 The Bill of Rights defines the right to property as follows: "No one may be deprived of property except in terms of law of general application, and no law may permit arbitrary deprivation of property."

80 Section 25 of the Constitution.

Although an analysis of the provisions of the Income Tax Act indicates that it *prima facie* infringes on a person's right to property, it falls within the limitations imposed by Section 36[81] of the Constitution.[82] The limitations recognise that the rights included in the Bill of Rights are not infinite but subject to acceptable limitations, for example, levying income tax.

The right to property refers to the rights of a person to use his or her assets (including cash) as he or she pleases.[83] If a person loses his or her property without the intention to transfer ownership, he or she has certain remedies to reclaim that property.[84]

When a person unknowingly makes an investment in a Ponzi scheme, he or she can institute action to regain ownership of the investment.[85] The transaction should be classified as void, resulting in the investor obtaining an immediate recovery right.[86] The court's decision in *MP Finance*[87] meant that any recoverable amounts would be reduced by the tax levied. It is submitted that the investor's right to property was therefore infringed upon. It is clear from the provisions of the Promotion and Protection of Investment Bill,[88] that it is the intention of the Bill to confirm and amplify the Constitutional right to property (both corporeal and incorporeal) and to protect investors from arbitrary deprivation, by the State, of their investments.[89]However, the arbitrary deprivation of property was never contemplated by the liquidator in argument to the Supreme Court of Appeal.

Although the imposition of tax on amounts received by the Krion Ponzi-type scheme limits the investor's right to property and ownership, one has to consider whether the infringement[90] is "reasonable and justified in an open and democratic society". It is suggested that the levying of taxes is reasonable and can be justified

---

81 This provision states that any right included in the Bill of Rights may be *"limited in terms of law of general application to the extent that the limitation is reasonable and justifiable in an open and democratic society based on human dignity, equality and freedom taking into account all relevant factors . . ."*.

82 Currie, I. and De Waal, J. 2005. The Bill of Rights Handbook, 5th edition. Landsdowne: Juta and Co.

83 *Gein v Gein*, 1979 (2) SA 113 (T) 1120.

84 Namely the possessory remedy (known as the *mandamant van spolie*) or section 300 of the Criminal Procedure Act No. 51 of 1977) Badenhorst, P.J., Pienaar, J.M. and Mostert. H. 2006. *Silberberg and Schoeman's The Law of Property*, 5th edition. LexisNexis Butterworths: Durban.

85 Latin maxim called the "*rei vindicatio*".

86 *ITC* 1545, (1995) 54 SATC 464.

87 *MP Finance Group CC (In Liquidation) v C:SARS, at 2.*

88 Promotion and Protection of Investment Bill 2013 (National Gazettes, No. 36995 of 1 November 2013). Pretoria: Government Printer.

89 Dean, O. and Kleyn M. 2014. South African Promotion and Protection of Investment Bill 2013- A Review. *Intellectual Property Watch.*

90 Section 36 of the Constitution of South Africa, 1996.

in that it provides the *fiscus* with income to finance government's expenditure.[91] However, as imposing tax on illegal transactions differs materially from the normal principles relating to the raising of taxes and levies, the reasonableness of the tax burden resulting from the decision in *MP Finance* must be measured against the constitutional obligation of both the *fiscus* and taxpayers alike to respect each other's fundamental right to property.

The unreasonableness of the tax imposed is further illustrated when considering all the possible tax implications associated with the transaction. Any interest an investor receives on his or her investment will be included in his or her gross income. However, history has taught us that very few investors in Ponzi schemes receive any return on their investments,[92] with the majority losing all or most of the money they invested. Interestingly, if payment is made to an investor at a higher interest rate than what could be obtained from a bank, it is seen as a gift[93] for insolvency purposes. In *Rosseau en Andere v Malan en 'n Ander*,[94] the court found that these payments can be set aside in terms of the Insolvency Act when the scheme collapses. All interest amounts received by investors from *MP Finance* were reclaimed from the investors irrespective of whether the amounts were received or were reinvested in the scheme and subsequently lost.

It is submitted that the taxing of the amounts received by the scheme result in an unreasonable treatment of the investors in light of the fact that the transaction is void. This can be illustrated by considering the consequences of a solvent scheme, the investor would invest R100 in the scheme. Although the scheme is solvent before the imposition of tax the capital amount available for distribution to the investor will now only be R68 (R100 – 28% normal tax [assuming it is a corporate taxpayer]). The effect of this judgment is that the investor lost part of his capital in favour of the *fiscus,* despite the fact that the transaction was void. Although the investor could in some situations claim the loss as a capital loss, the tax reliefs would be limited to a maximum of R3.72.[95]

---

91 Van Schalkwyk, L. 2001. Constitutionality and the Income Tax Act. *Meditari Accountancy Research*, Volume 9 (2001) at 285–299; Metcash Trading Limited v Commissioner for the South African Revenue Service and Another, (CCT3/00) [2000] ZACC 21; 2002 (4) SA 317.

92 Visser en 'n Ander v Rousseau en Andere NNO 1990 (1) SA 139 (A).

93 *Estate Jager v Whittaker and Another,* 1944 AD 246.

94 1989 (2) SA 451 (C) read with section 26 of the Insolvency Act, 24 of 1936.

95 R28 capital loss x (33.3% [capital gains tax inclusion rate] x 40 % [maximum marginal tax rate]), the total loss will be reduced by the annual exclusion as set out in par 5 of the Eighth Schedule of the Income Tax Act.

Conclusion

The article makes a contribution to the field of taxation by investigating whether the taxation of illegal receipts infringes on the right of the victims of illegal schemes not to be arbitrarily deprived of the ownership of their property right guaranteed by section 25 of the Constitution.

The article analysed the recent decision by the Supreme Court of Appeal in the case of *MP Finance*. The main principle the court had to decide on related directly to the taxation of illegal receipts, with specific reference to amounts received by Marietjie Prinsloo in operating the Krion Ponzi-type scheme. The Supreme Court of Appeal held that it was the intention of Marietjie Prinsloo to use the amounts received for her own benefit and the amounts were therefore subject to tax. The court, however, did not rule on the consequential effect or relationship between the investors and the scheme operators, collectively referred to as *MP Finance*. As legal counsel for the investors never pursued the pivotal issue concerning the right of the investors not to be deprived of their property as espoused under the Constitution, it is still unclear to what conclusion another court would have come in this matter had this argument been raised. What is clear now is that in terms of the Promotion and Protection of Investment Bill, any expropriation of investor property must be subject to just and equitable compensation.[96].

MP Finance drew a curious distinction between the relationship between the parties involved in the transaction (the scheme and the investor) and the relationship between the *fiscus* and the scheme. When considering the relationship between the investor and the scheme, it is clear that the investor had obtained a right against Marietjie Prinsloo and her family (the operators), and had a claim to the amount originally invested. Since the amounts received by the scheme are subject to income tax, a liability is created in favour of the SARS for the taxes due. When the scheme comes to its inevitable end, and is sequestrated, a preferential creditor's claim is created in favour of SARS.[97] This preferential creditor's claim under the Law of Insolvency infringes on the investors' right to property, as the original investment in the scheme is void, resulting in the investor being able to reclaim the investment – now reduced by the amount of income tax payable.

96 As espoused under the Promotion and Protection of Investment Bill 2013 (National Gazettes, No. 36995 of 1 November 2013).

97 Section 99 the Insolvency Act No. 24 of 1936.

References

Acts

South Africa. 1936. Insolvency Act No. 24 of 1936. Pretoria: Government Printer.
South Africa. 1962. Income Tax Act No. 58 of 1962. Pretoria: Government Printer.
South Africa. 1973. Companies Act No. 61 of 1973. Pretoria: Government Printer.
South Africa. 1977. Criminal Procedure Act No. 51 of 1977. Pretoria: Government Printer.
South Africa. 1984. Close Corporation Act No. 69 of 1984). Pretoria: Government Printer.
South Africa. 1996. Constitution of the Republic of South Africa Act No. 108 of 1996. Pretoria: Government Printer.
South Africa. 1988. Consumer Affairs Act No. 71 of 1988. Pretoria: Government Printer.
South Africa. 1990. Bank Act No. 94 of 1990. Pretoria: Government Printer.
South Africa. 1998. Prevention of Organised Crime Act No. 121 of 1998. Pretoria: Government Printer.
South Africa. 2007. Co-operative Banks Tax Administration Act No. 40 of 2007. Pretoria: Government Printer.
South Africa. 2013. Promotion and Protection of Investment Bill 2013 (National Gazettes, No. 36995 of 1 November 2013). Pretoria: Government Printer.

Books, articles and other publications

ArcelorMittal South Africa. 2013. Company History. [Online] Available at: http://www.arcelormittalsa.com/Company/History.aspx (Accessed 7 August 2013).
Badenhorst, P.J., Pienaar, J.M. and Mostert. H. 2006. Silberberg and Schoeman's The Law of Property, 5th edition. Durban: LexisNexis Butterworths.
Classen, L.G. 2007. Legality and Income Tax: Is SARS Entitled to Levy Income Tax on Illegal Amounts Received by a Taxpayer? *SA Mercantile Law Journal*, (19).
Coakley, G.J. 1998. The Mineral Industry of South Africa. *U.S. Geological Survey Minerals Yearbook*. [Online] Available at: http://minerals.usgs.gov/minerals/pubs/country/1998/9235098.pdf (Accessed: 14 August 2013).
Currie, I. and De Waal, J. 2005. The Bill of Rights Handbook, 5th edition. Landsdowne: Juta and Co.
Dean, O. and Kleyn M. 2014. South African Promotion and Protection of Investment Bill 2013 – A Review. *Intellectual Property Watch*. 13 February 2014. [Online] Available at: http://www.ip-watch.org/2014/02/13/south-africa-promotion-and-protection-of-investment-bill-2013-a-review/ (Accessed: 19 November 2014).
Department of Government Communication and Information Services. 2012. *South Africa Yearbook 2011/2012*. Pretoria: Government Printing Works.
Firoz, A.S. 2003. Steel Industry in Turmoil: Structural Crisis of 1990s. *Economic and Political Weekly,* (23).

Goldswain, G.K. 2008. Illegal Activities: Taxability of its Proceeds. *Tax Planning Journal,* (22).

Kühne, I. 2002. Prinsloo se Foon Suis van die Dreigoproepe. *Rapport,* Volume 1, June 2002. [Online] Available at: http://www.rapport.co.za/Suid-Afrika/Nuus/Prinsloo-se-foon-suis-van-die-dreigoproepe-20020601 (Accessed: 12 August 2013).

Mulder, N. 2002. Krion Voorlopig Gelikwideer ná "Piramide-bedrywighede". *Beeld,* Volume 6, June 2002. [Online] Available at: http://152.111.1.88/argief/berigte/beeld/2002/06/06/5/6.html (Accessed: 13 August 2013).

Muller, E. 2007. The taxation of Illegal Receipts. A Pyramid of Problems: A Discussion on ITC 1789. *Obiter,* Volume 28(1) at 166-181.

Olivier, L.O. 2008. The Taxability of Illegal Income. *TSAR* at 817.

Hutchison, D., Pretorius, C., Du Plessis, J., Hawthorne, L., Kuschke, B., Maxwell, C., Naude, T., and De Stadler, E. 2013. The Law of Contract in South Africa, 2nd edition. Cape Town: Oxford University Press.

SAPA. 2010. Vaal Still Feeling Krion Fallout. [Online] Available at: http://www.news24.com/SouthAfrica/News/Vaal-still-feeling-Krion-fallout-20101006 (Accessed: 12 August 2013).

Skalak, S.L., Lau, R. and Clarke, S. 2011. A Guide to Forensic Accounting Investigation, 2nd edition: Chapter 24. New Jersey: John Wiley and Sons.

Smith, D. 2002. Braving the Social Consequences of Fraud. *Independent Online,* Volume 28, June 2002. [Online] Available at: http://www.iol.co.za/news/south-africa/braving-the-social-consequences-of-fraud-1.88850 (Accessed: 12 August 2013).

South African History Online. 2013. *Dr Hendrik Johannes van der Bijl.* [Online] Available at: http://www.sahistory.org.za/dated-event/dr-hendrik-johannes-van-der-bijl-sa-industrialist-who-laid-foundation-establishment-esco (Accessed: 7 August 2013).

South African Reserve Bank. 2013. Selected Historical Exchange Rates and Other Interest Rates. [Online] Available at: http://www.resbank.co.za/Research/Rates/Pages/SelectedHistoricalExchangeAndInterestRates.aspx (Accessed: 31 May 2013).

Stein, M. 1998. Tax the Fruit of Fraud: The Tale of Two Cases. *Tax Planning,* 12(5).

Tempelhoff, E. 2002a. Skemavrese in Vaaldriehoek. *Beeld,* Volume 21, May 2002. [Online] Available at: http://152.111.1.88/argief/berigte/beeld/2002/05/21/6/13.html (Accessed: 13 August 2013).

Tempelhoff, E. 2002b. Krion-6 uit Selle, Weer Gegryp (2002) *Beeld,* Volume 27, July 2002. [Online] Available at: http://152.111.1.88/argief/berigte/beeld/2002/07/27/1/2.html (Accessed: 13 August 2013).

Tyrer, L. 2007. Steel Exports Fuel SA's Production Growth. *Engineering News*. Volume 13, July 2007. [Online] Available at: http://www.engineeringnews.co.za/print-version/steel-exports-fuel-sa039s-production-growth-2007-07-13 (Accessed: 14 August 2013).

Vaal Triangle Information. 2013. Vaal Triangle History. [Online] Available at: http://www.vaaltriangleinfo.co.za/history/overview/overview4.htm (Accessed: 31 May 2013).

Van Doesten, J. 2010. Tax Implications of Ponzi Schemes. *The Taxpayer,* Volume 6: Cape Town.

Van Schalkwyk, L. 2001. Constitutionality and the Income Tax Act. *Meditari Accountancy Research,* Volume 9 at 285.
Van Wyk, A. 1991. Vaal Triangle: A Region of Growth and Prosperity. Randburg: Target Communications.

Case law

Californian Copper Syndicate v Harris, 5 TC at 166.
CIR v Delagoa Bay Cigarette Co Ltd 1918 TPD 391, 32 SATC 47.
CIR v Genn, 20 SATC 113.
Commissioner v Glenshaw Glass Co., 348 U.S. 426 (1955).
COT v G, 43 SATC 159.
Estate Jager v Whittaker and Another, 1944 AD 246.
Fourie NO and Others v Edeling NO and Others, 2004 ZASCA 28.
Gein v Gein, 1979 (2) SA 113 (T) 1120.
Geldenhuys v CIR, 14 SATC 419.
ITC 1545 (1988), 54 SATC 464.
ITC 1789 (2005), 67 SATC 205.
ITC 1792 (2005), 67 SATC 236.
Janse van Rensburg NO v Steyn, 2011 ZASCA 71.
Johnson v The Queen 2011 TCC 540.
Lategan v CIR, 2 SATC 16.
Metcash Trading Limited v Commissioner for the South African Revenue Service and Another, 2000 ZACC 21, 2002 (4) SA 317.
MP Finance Group CC (In Liquidation) v C:SARS, 69 SATC 141.
Rosseau en Andere v Malan en 'n Ander, 1989 (2) SA 451 (C).
State v Prinsloo and Others, 2010 ZAGPPHC 163.
Visser en 'n Ander v Rousseau en Andere NNO, 1990 (1) SA 139 (A).