



# DAVEY'S Locker

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## Compensatory investment awards

### And prescribed interest

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#### Prescribed rate change

The Prescribed Rate of Interest Act, which governs the rate of interest a creditor may claim in circumstances other than an agreement or the application of another law (such as tax legislation, which fixes the current official rate as 9%), has finally been brought into line with the economic reality after a twenty-one-year hiatus.

Effective as from 1 August 2014, the prescribed rate is reduced from 15,5% a year to 9% (136 *TSH* 2014). This 9% rate applies only to new debt judgments (including compensatory awards) arising on or after 1 August.

#### Compensatory investment awards

The various Financial Services Ombuds' compensatory awards (termed 'Determinations') will thus now fix the interest rate for the

period from the Determination date to the date of payment at 9% a year.

This development leads me to the tax treatment of a compensatory award by the FAIS Ombud in favour of a client who has suffered loss, owing to the intentional or negligent behavior of a financial services provider.

(Under the Ombud's Rules on Proceedings (BN 81 of 2003), a financial adviser is not responsible for investment performance, unless he or she stated that there was a guarantee or unless there was misrepresentation or gross negligence.)

The general tax rule for compensatory loss arises from the celebrated *Burmah Steamship* case, and states that one must enquire whether the compensation fills a hole in the capital structure of the recipient (capital nature) or a hole in

the recipient's profits (revenue). An example of the second type of compensation is afforded by a loss of trading stock, which would thus be of a revenue nature and taxable.

Thus a compensatory award (say for a share scam) to the average client who is investing for the medium to long term would be of a capital nature, while an award to a get-rich-quick, short-term trader would arguably be of a revenue nature and hence taxable.

Naturally, one has to apply the tax law to the facts of each case and determine the intention of the investor-client.

As for the prescribed interest rate component of an award, interest is, sadly, inherently taxable, subject to the exemption thresholds.