Unjustified enrichment: should South Africa venture into the thick forest of passing-on defence?

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UNJUSTIFIED ENRICHMENT: SHOULD SOUTH AFRICA VENTURE INTO THE THICK FOREST OF PASSING-ON DEFENCE?
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There is usually a tension in the law of unjustified enrichment when it comes to sanctioning a defence of passing on. The concept “passing on” in the law of unjustified enrichment essentially entails that the claimant has shifted onto a third party the “financial” burden that is consequent upon the defendant's unjustified enrichment. Several jurisdictions formulate their enrichment doctrine requiring a “mirror-image loss-gain”, that is to say, the claimant can only recover from the defendant what he has lost to the defendant. If the claimant were allowed to recover more than his loss, the law would be punishing the defendant and enriching the claimant at the defendant's expense. For this and other reasons some think that there should exist symmetry in the law of unjustified enrichment in that where the defence of change of position (loss of enrichment) is recognised, the passing-on defence should equally be sanctioned as the reverse face of change-of-position defence on the claimant's side. This paper explores these issues in depth and argues that the need for such symmetry is misconceived. The defence of passing on is, however, sustainable in certain cases and should be recognised not only for policy reasons but also for reasons of principle.

Résumé: Il y a habituellement une tension dans le droit de l'enrichissement injustifié si l'on admet la défense de transmission («passing on») ou non. Plusieurs juridictions formulent leur doctrine de l'enrichissement exigeant une «image-miroir perdu-gagné», c'est-à-dire que le demandeur ne peut récupérer du défendeur seulement ce que lui a perdu. L'argument en faveur d'une telle équation de gain-perte est que si le demandeur était autorisé à récupérer plus que sa perte, la loi punirait, d'une part, excessivement le défendeur et, d'autre part, enrichirait le demandeur aux frais du défendeur. Pour cette et pour d'autres raisons, certains auteurs pensent qu'il devrait exister une symétrie dans le droit de l'enrichissement injustifié dans la mesure où la défense de changement de position (perte d'enrichissement) est reconnue, la défense de transmission devrait également être admise comme l'inverse de la défense de changement de position du défendeur. Cet article explore ces questions en profondeur et soutient que la nécessité d'une telle symétrie est mal conçue. La défense de transmission est cependant soutenable dans certains cas et doit être reconnue non seulement pour des raisons politiques, mais aussi pour des raisons de principe.

Keywords: passing-on, mirror-image loss-gain, unjust enrichment

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Introductory remarks

While many jurisdictions around the world have discussed the notion of passing-on defence in their law of unjustified enrichment, discussion of this nature is virtually non-existent in South African law. However, the principles upon which this defence is premised and has been advanced in other jurisdictions are not necessarily strange to the South African legal system. The concept of passing on arises mainly in the tax context and to some extent in antitrust (competition) law. Passing on as a concept in the law of unjustified enrichment essentially entails that the claimant has shifted onto a third party the “financial” burden that is consequent upon the defendant’s unjustified enrichment. In the most common scenario, a business apparently liable for tax makes payment to the government, but it also attempts to recoup its losses by raising the prices it charges its customers. When the tax is subsequently determined to be improper or inapplicable, the business seeks repayment as a relief. The government resists such a claim, arguing that its enrichment came not at the claimant’s expense, but rather at the expense of the claimant’s customers.

As the concept of passing on arises mostly in the tax context and in antitrust (competition) law, it is also obvious that the ideals governing these bodies of law in South Africa are to some extent similar to those of other jurisdictions. In South African law, for example, these ideals are encapsulated in the rule of law or the principle of legality\(^1\) enshrined in the Constitution of the Republic of South Africa, 1996 (ss 1–2); the rule of law that entrenches the Constitution as the supreme law of the land; the rule that a right enshrined in the Bill of Rights can only be overridden by a law of general application (Constitution, s 35); and the duty entrusted to the courts to develop the common law in line with constitutional principles, to cite a few examples.

The principle of legality is relevant especially when the claim arises from “unlawfully demanded taxes or levies” because at one level passing on is “related” to the illegality defence – and can present the features of the \textit{in pari delicto} rule or simply as a one-sided illegality allegation. On another level it raises problems of good faith in connection (if taken together) with the knowledge requirement. If the claimant knew (or suspected) that the tax

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\(^1\) See, for example, the recent Dutch cases \textit{TenneT v ABB} (Hoge Raad, 8 July 2016) confirming the availability of passing-on defence under Dutch law (in antitrust cases) with the application of arts 6: 95–97 of the Dutch Civil Code (BW) and the deduction of collateral benefits under art 6: 100 of the Dutch Civil Code (BW). This is an appeal from Gerechtshof Arnhem-Leeuwarden case No 200. 126. 185 (2/9/2014). See also the recent English case \textit{Sainsbury’s Supermarkets Ltd v MasterCard Incorporated} (Competition Appeals Tribunal case No 1241/5/7/15 (T) (14 July 2016). See also \textit{Kleinwort Benson Ltd v South Tyneside Metropolitan BC} (1994) 4 All ER (Com Ct) and \textit{Kleinwort Benson Ltd v Birmingham City Council} (1997) QB 380 (CA).

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or levy being demanded was unlawful or “illegal” but did not protest its unlawfulness and consciously passed the tax or levy on to the customers in the knowledge that he would recoup more profits, the intention (action) of passing it on can be said to be tainted with “sharing” in the unlawful act (in pari delicto), albeit indirectly. The claimant cannot now be heard to say that he had acted without knowledge and ask the court to assist.

If the defendant is said to be a “wrongdoer”, then no enquiry should be made whether the defendant’s gain is commensurate with any loss the claimant had suffered or might suffer, and the defendant cannot successfully defend himself by saying that the claimant “passed on” the taxes which the claimant had paid.

The situation is different where the unlawfulness of the statute/regulation was on both ends revealed later, say by a court decision, and all along neither of the parties knew or suspected its unlawfulness. Where there was no protest from the claimant, one could also add that the lack of this protest brings the claim into the realm of voluntarily made payments. Here the absence of coercion from a public authority as a defendant would also entitle it the defence of “loss of enrichment”. If it can be shown that the public authority simply acted under the statutory provisions which imposed “penal” sanctions but had not threatened the taxpayer, it is entirely understandable that the court would allow such a public authority to plead loss of enrichment (or change of position). This is because a public authority which mistakenly thought that it had the power to levy the tax can be said to have acted in good faith.

As it is with the claimant, here the same analogy applies to the defendant, that is to say, a public authority which made the demand knowing that it was illegal to do so must surely be deemed to have exerted illegitimate pressure and cannot have the benefit of the defence. However, the problem with the good faith aspect in the passing-on defence is how to categorise a public taxing authority as a “wrongdoer” when the tax collector has acted under a “genuinely” passed legislation, and only at a later stage does it transpire that the legislation (or regulation) was issued either ultra vires or is invalid for some or other reason. Although it is theoretically possible to ascribe wrongdoing to a public entity, in practice the circumstances leading to the imposition of “unlawful”, “inappropriate” or “ultra vires” taxes or levies onto the claimant can hardly fit the description of “intentional” wrongdoing.

From the aforesaid, is it then vital to the unjustified enrichment doctrine to sanction a defence of passing on? If so, when, why or why not? What hurdles will be encountered if either option is chosen?

Despite the scarcity of discussion on the issue in South African legal literature, Visser briefly explored the issue in his recent book and proposed a probable avenue for South African law. On the other hand Du Plessis,

in his recent book on unjustified enrichment, mentions the defence of passing on. However, unlike Visser who explores the pros and cons of this defence, Du Plessis simply mentions that

where a claimant alleges that he was impoverished, the defendant can accept that there was initial impoverishment, but argue that the claimant has subsequently “passed on” the impoverishment to third parties. It is doubtful, though, whether South African law recognises such a defence; passing on would generally be regarded as irrelevant.

He concludes that “passing on has been dealt with in the context of impoverishment requirement”. Then he cross-references his earlier assertion that “impoverishment in unjustified enrichment is determined by establishing the total effect on the defendant’s patrimony”. In determining enrichment, the total net effect of the enriching event on the defendant’s patrimony is taken into account. Du Plessis goes on to assert that a “similar” approach is presumably also followed when determining the claimant’s impoverishment. He acknowledges, however, that some difficulty surrounds the application of this principle if the claimant has “passed on” the impoverishment to third parties. On deeper scrutiny, Du Plessis nevertheless acknowledges that the measure of South African law of unjustified enrichment, in most instances, is capped by that which was received as sine qua non requisite, save some qualification.

The reason presented for capping the claim in most legal systems is that if it were otherwise, either the claimant would in turn enrich himself if he were to recover more than he had lost, or an enrichment claim would mirror punishment if the defendant were to disgorge more than the claimant’s loss.

This paper examines the issue of passing on by taking into account mostly Visser’s recent suggestion. The paper concludes that, where the law of unjustified enrichment is premised on mirror-image loss-gain, that is to say, where the measure of enrichment is capped by that which was received as a sine qua non requisite, the ground will be fertile for the recognition of a passing-on defence. South Africa is indeed one of the

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5 Du Plessis op cit note 4 at 341–342.
6 Du Plessis op cit note 4 at 44–45 is of the view that it is possible to relax the impoverishment requirement. The area where the retention of the “impoverishment requirement is most likely to be challenged is ‘enrichment by taking’ or infringement of another person’s right”.
7 See the European Court of Justice case Just I/S v Danish Ministry for Fiscal Affairs (case 68/79 [1980] ECR 501, para 26) that refers to the defence in such language: “[Community law] does not require an order for the recovery of charges improperly made to be granted in conditions which involve the unjust enrichment of those entitled”. See also the description given to the fourth specific defence by the English Law Commission (Law Com. No 227 (1994) – Restitution: Mistake of Law and Ultra Vires Public Authority Receipt and Payments – paras 10.5–10.8).
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legal systems premised on the mirror-image loss-gain principle in the law of unjustified enrichment. Thus, the paper argues that, unless the South African legal system gives up the mirror-image loss-gain requirement, it should also sanction a passing-on defence as a matter of principle, if not in toto then at least in part.

Some theorists attempting to systematise enrichment law defences view passing on, if recognised in the legal system, as a form of a changed circumstances defence (change of position)8 that can thwart, in full or in part, a claimant’s prima facie right to recover a benefit unjustifiably acquired by the defendant. However, the changed circumstances occur instead on the plaintiff’s side and not on the defendant’s. Because the claimant’s circumstances have so changed, the defendant can replicate to the claim that the claimant’s right to recover his benefit is either cancelled out or at least has been diminished correspondingly to the new changed position. An underlying idea to this view of passing on is the reasoning that a claimant is only entitled to recover that which he can prove he has lost to the defendant who is now better off, while the claimant has been made worse off. If this quadration cannot be established, then the law should favour the defendant.

Passing on in South African law

The defence of passing on, as said above, is virtually unknown in South African law9 although the principles upon which it is premised are present. Because of the presence of these principles and the ideals guiding the defence, Visser dealt briefly with the notion in his book Unjustified Enrichment10 and questions whether it should be sanctioned as a matter of principle, given that the system already recognises a loss of enrichment defence. In essence, Visser’s conclusion is that it should not be recognised, chiefly because of the near impossibility of proving it. In general, an improperly demanded tax either as a result of some sort of “indirect pressure” exerted upon the taxpayer who is constrained to pay the tax based on some business or personal vicissitudes, or simply

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9 Visser 2008 op cit note 3 at 748–752 deals briefly with the notion of passing on, and questions whether South African law should consider recognising such a defence. After a brief overview of other legal systems that seemed to him had such a defence, and considering the arguments in favour and against the defence, Visser came to the conclusion that South Africa should not venture into this area, even if on principle he could have sanctioned it, as the intricacies (or near impossibilities) of proving such defence seem to him insurmountable.

10 Visser 2008 op cit note 3 at 748–752.
as a tax that has been found not to be owing because of the illegality of the instrument upon which it was exacted, will simply fall under the general ambit of “undue payment”. In principle, the *condizationes* are able to deal with such a matter as payments made under void or non-existent agreements, therefore, *sine causa*. Because it is a payment *sine causa*, the claimant is entitled to recovery.

However, owing to the specificity of the context in which they arise, it is not strange that the applicability of the common law is often directly or indirectly ousted by statutes. So, it is to be expected that various statutes dealing with tax matters will craft a provision for the recovery of money paid as tax which is not owed. This tendency situates the majority of the cases in the context of statutory law and ultimately it may be a matter for public law. For this reason, in practice, the number of cases entitling claimants to recover unduly paid tax-money where private-law principles would need to be relied upon is likely to be small. Equally small would be the number of cases in which, for example, claimants will be allowed to rely on their private-law right in preference to those rights conferred by statute, for example, because they wish to take advantage of a more flexible system of rights in preference to those conferred by statute – such as prescription period\(^{11}\) or right to interest.

Nonetheless, cases arise where “common-law” principles are in play and no issues of public law arise. I will briefly deal with some of these cases. For example, similar issues mentioned in the famous English *Woolwich*\(^{12}\) case arose in *Eskom v Thabo Mofutsanyana Distrikraad*\(^{13}\) where *Eskom* claimed back R130 000 paid in terms of a services levy imposed by the Thabo Mofutsanyana Distrikraad (District Council). Similar to the *Woolwich* factual scenario, *Eskom* also doubted its liability to pay the levy and sought legal advice from two senior advocates, who unfortunately gave conflicting opinions. At first *Eskom* refused to pay and the dispute ended up in court. While the case was in progress, *Eskom* decided to pay the amount of the levy because it would be “politically incorrect to antagonise the local authority and also to avoid penalties if the payment turned out to be due”. After most of the amount had been paid to the District Council, the court ruled that the levy was indeed not due. *Eskom* meanwhile still paid R16 000 of the total amount after the judgment had been given, but then decided to reclaim the full amount, which resulted in the present case. The case is fully commented by Visser\(^{14}\) and need

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\(^{11}\) See, for example, the approach adopted by the appellant in *Eskom v Bojanala Platinum District Municipality* 2005 (4) SA 31 (SCA).

\(^{12}\) *Woolwich Equitable Building Society v IRC* 1993 AC 70 (HL) 101 at 173 (*per* Lord Goff).


\(^{14}\) Visser 2005 op cit note 13.
not be repeated here save to acknowledge that, contrary to the court’s interpretation, it indeed makes sense that exacting a tax which is not owed squarely falls within the meaning of property in section 25(1) of the South African Constitution. As Visser argues, it would make no sense that the same provision allowed one’s house not to be expropriated by the state without compensation, but allowed one’s bank account to be cleared out by the authorities.

There must therefore be uniformity about how the provisions of laws are interpreted. For our purpose, however, the further matter that the case raises is indeed the “voluntariness of the payment” and to what extent the law can allow “indirect coercions” such as “fear of penalties” and “political incorrectness” as sufficient “coercion” to cancel out one’s free will. In my view, in the absence of other policy considerations, coercions of this nature should not be entertained as sufficient ground to cancel the “voluntariness” aspect of the payment. The case is of further importance because it raises the question as to what extent it can be said that South African law recognises a recoverability of \textit{ultra vires} demanded taxes as of right. Is the right to recover a \textit{prima facie} right only or is it a mandatory right?

On one analysis it could be argued that the right to recover tax-money paid under \textit{ultra vires} demand is a \textit{prima facie} right only because it is partly premised on the rationale of good governance. Although, by holding that such a right is “\textit{prima facie} only”, one is not necessarily saying that the right must by its nature be absolute. However, what transpires from labelling or treating a right as “\textit{prima facie} only” is its susceptibility to being an interest that can be overridden by indeterminate policy considerations.\textsuperscript{15} The susceptibility to be overridden by policy considerations brings that right within the sphere of those rights that usually resemble a legitimate expectation. If a “right” is treated like a legitimate expectation, the weight that the courts will attach to such a “legitimate expectation” will vary with the context.\textsuperscript{16} Non-fundamental rights are often specifically designed to be rather vague, precisely so that courts can engage in a “balancing exercise” between the individual right and the broader public interest.\textsuperscript{17} When a right is classified by its nature as fundamental, it can be argued

\textsuperscript{16} Adler op cit note 15 at 168.
\textsuperscript{17} See, for example, the analysis of “Non-absolute fundamental rights” in the context of European Community Law in C. Hilson. 2004. “What is a right? The right between community law, fundamental and citizen’s right in EU Law”. \textit{European Law Review}, 29:636 at 640: “when a right is classified by its nature as fundamental, it can be argued not only for the broad interpretation of the initial or \textit{prima facie} right, but also for a narrow interpretation of the exception to that right”. Thus, explains the writer, ordinarily exceptions to a right must be interpreted restrictively.
not only for the broader interpretation of the initial or *prima facie* right, but also for the narrow interpretation of any exception to that right. 18

On another analysis, however, it seems also clear that where the claimant has proved his claim, the court has no discretionary powers to order restitution just because in the circumstances of the particular case it might be just and equitable to do so. If the enrichment was gained at the expense of the claimant where there was no legal ground to have demanded the payment of the tax in the first place, the principle should still apply. Otherwise the rule of law becomes vulnerable to discretionary application and uncertainty gains control of the law.

Where the defence of passing on is successfully applied, it usually denies restitution to the claimant because of the existence of third-party rights which the court perceives to be stronger than the right of the claimant. 19 Briefly stated, what is really at stake in the recovery of unlawfully charged taxes is the dilemma to (i) prevent the government from enriching itself by infringing the very law it is expected to protect, and (ii) thwart the claimant’s undeserved windfall that he would gain at the expense of the innocent ultimate taxpayers without having borne any financial burden (or any loss) himself. This dilemma is often resolved on policy grounds that may resemble the adage “as between ‘two innocents’, the position of the defendant is to be preferred”.

In English law there are at least three possible approaches 20 that could be followed to recover payments demanded “*ultra vires*”. One of these, like in South African law, 21 relies upon mistake. But ultimately, owing to the constitutionality of the matter and the sphere from which it arises, English law has found that public law (although this approach is equally controversial) is the best arena in which to deal with *ultra vires* demanded taxes. So, based on the provision of s 32 of the South African Constitution, it could be argued that the just administrative action guarantee provided for in that section could allow the recoverability of an unduly imposed levy on a citizen. Because the undue imposition of the levy is in violation

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18 Hilson op cit note 17 at 641.
20 The first is, in essence, that the basis of recovery should be limited to cases where the claimant paid money under duress or mistake; the second approach is equally founded on some subtle notion of duress or coercion. Duress in this context is to be seen as some sort of a modified private law, where a special standard for government officials should apply. This category could be seen as a unique enrichment category where the combination of breach of duty and the inherent coercion in the public authority’s demand renders the payment involuntary and provides the basis of recovery. The third approach is based on the general enrichment principle and provides that money paid by a citizen to a public authority pursuant to an *ultra vires* demand is *prima facie* recoverable by the citizen as of right, and the right to recover should require neither mistake nor compulsion (see Woolwich *supra* note 12).
21 See for example *Bowman, De Wet and Du Plessis NNO v Fidelity Bank Ltd* 1997 2 SA 35 (A).
of the law, the citizen should recover as of right without a reference to the error requirement in proving an ordinary *condictio indebiti* claim.

For comparative law insight, it is also worth noting the reasoning in the Canadian case *Kingstreet Investments v New Brunswick (Finance)*. 22 In this case the Canadian Supreme Court departed from the proposition that “the law of enrichment is not designed to confer windfalls to claimants who suffered no loss”. Instead, it adopted a new proposition that the law of enrichment “is not concerned by the possibility of the claimant obtaining a windfall because it is not founded on the concept of compensation for loss”. South African law is one of the legal systems that support the mirror-image loss-gain, despite recognising the defence of loss of enrichment and being geared towards the acceptance of a general principle. It can therefore still be asked whether the insistence upon loss-gain does not place South African law in a better position for recognising the defence of passing on because that recognition would indeed bring some symmetry in the law. So far, however, no direct case has dealt with passing on in South Africa. Therefore, the terrain is still unexplored.

**Should South Africa venture into the passing on forest?**

*The emerging view*

South African law, as just said, does not yet have an “official pronouncement” on whether to sanction or reject passing on in its law on unjustified enrichment. However, looking at how the field is conceived, the ground could indeed be fertile for sanctioning. The system requires a “mirror-image loss-gain”, which is one of the strongest arguments in passing-on issues. However, Visser explored the matter in his book and advanced what one would call a preliminary view. 23 This view may eventually take hold in the country or be refined as other theorists and the courts confront the practicalities of the matter. Thus far, that proposition has been essentially a “no defence” approach, save where it is sanctioned by legislation.

In Visser’s preliminary view, South African law should not venture into a passing-on defence owing to the complexities inherent in proving its extent. 24 These complexities arise because, when the defendant (the state) alleges that the claimant has fully recouped his losses – that is to say, the amount “shifted” onto third parties (usually customers), which corresponds to the amount transferred to the defendant – the claimant may allege (and business claimants do usually contend) that it has not entirely recouped its

23 I opt for calling it a preliminary view because if one looks at, and compares the detailed discussions of other defences in the book and other writings of the author to the bird’s-eye view devoted to passing on, the imbalance indicates that the author did not explore several contours of the defence, but might do so in the future and eventually refine the preliminary view.
24 Visser 2008 op cit note 3 at 752.
losses. If the defendant cannot immediately disprove that allegation, the next limb of the defence is how to assess the measure of the claimant’s loss and therefore the value of the defendant’s enrichment that corresponds to that loss. (It should be remembered here that South Africa is one of the legal systems that requires a mirror-image loss-gain.) Ordinarily the claimant, in the operation of his business, may have increased the price of his products or services as part of his operating costs. It is not necessarily so that the entire amount which the defendant alleges to have been passed on to the customers is indeed what the claimant has “recouped as its losses”. The assessment of the values in these contexts becomes very complex and apparently impractical for the administration of justice.

When the claimant objects that he did not fully pass on the cost of the inappropriate tax through a price increase, but alleges that his business was affected either through the costs, say, of inputs, or that the level of his business output had to be adjusted owing to the impact of the price increase in the market or other factors, then the practical problem becomes that of estimating or calculating the elasticities\(^{25}\) of supply and demand of that product or service in the market. Today’s advanced econometrics in conjunction with related disciplines can certainly estimate with near mathematical precision the results, although all of it may depend, inter alia, on the strength of the economic assumptions made and the availability of data or its collection in the relevant market or industry.

However, despite the help of advanced and sophisticated econometrics modelling, economists still disagree on the route to follow in calculating elasticities of this nature. They seem to agree only on the difficulty of the task. They usually estimate the different values of elasticities in relation to the supply and demand, the price and other variables to determine what exactly was passed on and what was not and, if anything was passed-on, at what stage, how and why. Hence, if a legal system ventures into accepting the passing-on defence, but in a given case the extent of such passing on

\(^{25}\) Elasticity is understood as the measure of the responsiveness of one variable to changes in another. Economists have identified four main types of elasticity: price elasticity, income elasticity, cross-elasticity and elasticity of substitution. **Price elasticity** measures how much the quantity of supply of a good, or the demand for it, changes if its price changes. If the percentage change in quantity is more than the percentage change in price, the good is said to be price elastic; if it is less, the good is said to be price inelastic. **Income elasticity** of demand measures how the quantity demanded changes when income increases. **Cross-elasticity** shows how the demand for one good (e.g. coffee) changes when the price of another good (e.g. tea) changes. If the said goods can substitute each other (e.g. coffee and tea) the cross-elasticity will be positive: an increase in the price of tea will increase the demand for coffee. If the said goods are complementary (e.g. tea and teapots) the cross-elasticity will be negative. If the said goods are unrelated (e.g. tea and oil) the cross-elasticity will be zero. **Elasticity of substitution** describes how easily one input in the production process, such as labour, can be substituted for another, such as machinery. (For an explanation of these and other terms, see among others, *The Economist*, whose electronic version on the issue is made available at [http://www.economist.com/research/Economics/alphabetic.cfm?terms/](http://www.economist.com/research/Economics/alphabetic.cfm?terms/). (Accessed 26 February 2017).
is disputed, it is almost certain that the success of the defence will require gathering complex evidence of this nature. The litigants must then be prepared to face the inherent difficulties (and probably also the costs) involved in this process. Among the various difficulties that are likely to be encountered, the following merit some attention and description:

(i) **Supply and demand patterns:** Although it is possible to estimate with a fair degree of precision either the demand or supply elasticity for a certain product or service, it is exceedingly difficult to estimate both simultaneously, say the economists.\(^{26}\) That is so because demand estimation is normally facilitated when demand is relatively constant but supply is shifting (increasing or decreasing). The interaction between different supply patterns and a constant demand pattern enables the value of the demand to be established precisely.\(^ {27}\) However, given that in this instance the supply is also shifting, the estimation of the precise pattern, and consequently the precise value of the amount passed on, become difficult. Conversely, where supply is constant but demand is shifting, the estimation of the supply pattern is facilitated because the intersections between the supply pattern and the different demand patterns enable the values along the supply curve to be determined precisely. But, again, the estimation of the demand in turn becomes difficult. Consequently, because of these difficulties, economists are generally agreed that in these circumstances, trying to identify both supply and demand


\(^{27}\) Landes & Posner op cit note 26 at 619.
patterns is often a statistical nightmare\textsuperscript{28} and the outcome may be an unwarranted result.

(ii) **Time lag:** There will be a time lag between the time that the inappropriate tax is imposed and paid, and the time it is discovered to be unlawful and the claim instituted. Because of such a time lag, it is almost certain that there will be variations and fluctuations at certain periods in the demand and supply patterns. The elasticity values of these variables will also yield different passing-on values depending on the extent of those changes because elasticities may depend on the time period buyers and sellers have in which to adjust to the price change.

(iii) **Class of products or services:** When only one class of product or service is traded, only two elasticity estimates are required. Thus, statistical problems multiply as the class of products or services expands.

In the light of these complexities, it is reasonable to give credit to the “no defence” view in order to spare the courts the nightmare of venturing into the thick forest of econometrics and statistical evidence chiefly based on economic assumptions and estimates. The “no defence” view would also be supported by the following arguments:

(i) **Undermining the rule of law:** Allowing a passing-on defence in any fashion would directly or indirectly undermine the rule of law (or the principle of legality). It would do so directly because where “illegality” has been sufficiently proved, the government is

\textsuperscript{28} See GR Zodrow. 1999. “Tax Incidence”. In J Cordes & R Ebel (eds). *Encyclopaedia of Taxation and Tax Policy*. New York: Urban Institute Press at 200–202. According to Zodrow, financial economists have in the past decades constantly used three basic approaches to analyse tax incidence, namely “partial equilibrium analysis”, “static general-equilibrium analysis” and “dynamic general equilibrium analysis”. The first and most widely used analyses the effects of taxes in a theoretical model of the economy but it markedly differs from the other two approaches in various respects, such as the number of markets analysed, the extent to which the factor “supply” is assumed to be fixed, the method of capital accumulation, and the extent to which transitional problems are addressed. The second approach is still closely related to the first because it involves numerical simulations of tax effects in models that are basically complex variants of the analytical models. The third approach calculates incidence by estimating individual tax burdens directly using large micro-data sets. Analysing in further detail the “partial-equilibrium analytical model”, for example, and applying it to a single market (in this case the assumption was to ignore any tax-induced effects in other markets) Zodrow observes that the results demonstrate that “incidence is determined primarily by the extent to which individuals or firms are able to change their behaviour to avoid the tax. This flexibility is typically measured by price elasticities of demand and supply”. By way of example he illustrates that “the burden of an excise tax tends to be borne by consumers if demand is relatively inelastic – that is, if consumers are unable to substitute away from consumption of the taxed good; by comparison, the burden of an excise tax tends to be borne by producers if supply is fairly inelastic”. In limited cases, “the tax is borne fully by a single group; for example when the demand is perfectly inelastic or supply is perfectly elastic (as is the case with constant return to scale in production [i.e. mass production], consumers bear the entire burden of the excise tax.
nonetheless allowed to get away with it.²⁹ It would do so indirectly because by allowing the government to plead passing on, the system is incidentally discouraging claimants with genuine cases or with sufficient knowledge of the government’s “impropriety” in imposing taxes or other “misconducts”, from bringing actions against the government. Claimants would be discouraged because they know they might be overwhelmed with the evidentiary burden of disproving passing on in their business operations. In this sense, the rule of law is undermined as the system takes away or dilutes the right of the citizen to challenge government misconduct by imposing on him a burden of proof that might be complex and costly.

(ii) Straining the judicial system: Passing on should also be rejected for its inherent tendency to put excessive strain on the judicial system by trying to reconstruct “price and output decisions” in the courtroom.

In spite of the above propositions, almost all proponents of the “no defence” argument agree that, in principle, the defence is “sound” and logical, discarding it only for policy considerations.³⁰ Thus, what the conventional wisdom really advocates is allowing things to be simple and expeditious. Is it then a sound policy for a legal system to completely give up a principle it recognises to be defensible merely because of the complexities of proof? Are such complexities insurmountable in any and every case that may raise a passing-on situation?

The main policy being protected with the “no defence” view, however, seems to be chiefly the administrative convenience of simplicity and expediency, apart from what was termed above as “the principle of legality” or, put in other words, the policy of divesting illegal taxes to safeguard the rule of law. I fully agree that this approach accords rationality in the decision-making process, and if tax refunds are to be restricted to those who “bear the burden of the tax”, then perhaps the legislature, rather than courts or academics, are the proper source of such rules.³¹ The private law of unjustified enrichment might then be ill-equipped to absorb the complexity necessary for such decision making.

³⁰ Visser 2008 op cit note 3 at 752, agreeing with McInnes on this point, puts the matter this way: “the notion that an action based on unjustified enrichment should not be used to enrich the claimant is one which no-one would oppose in principle but the logistics of giving effect to that idea through the defence of passing on would be just too much”. M McInnes. 1997. “Passing on in the law of Restitution: A Reconsideration”. Sydney Law Review. 19:179 at 199.
³¹ Woodward op cit note 19 at 930.
However, let us not lose sight of one thing: the problem with the “no defence” approach is in its very simplicity, especially in tax matters. The “no defence” approach seems to overlook or underrate a legitimate view expressed in any fiscal legislation that a tax refund should not overcompensate claimants; or, in other words, it should not enrich them at the expense of innocent taxpayers. Furthermore, the “no defence” approach in the tax arena does not capture the full complexity and subtleties that may underlie decisions in this area as it may lack the flexibility to operate across a range of unjustified enrichment cases in which courts might encounter a passing-on defence. That being the case, is there any way that might capture those subtleties and deal with the complexity without destroying the rationality, predictability and certainty of the decisions safeguarded by the “no defence” approach?

An exploratory road map to a qualified passing-on defence

To answer the questions above we may need to draw some lessons from competition (antitrust) law, as the situations leading to possible passing on in unjustified enrichment cases are to some extent similar or analogous to those arising under competition law, namely the allegations of “price increase”, “shifting fully or partially the burden of a price increase”, using “control mechanisms” such as “increasing outputs” or “decreasing input costs”, “using substitutes”, and so on.

Although the task of proving passing on is difficult and complex, as acknowledged by economists, the difficulties should not be overstated. It is plain that in real life not all situations in which passing on is at issue present similar fact patterns. For this reason the difficulties can be qualified and in appropriate cases even “discounted”. That is so because in various circumstances in which the claimant will challenge the extent of passing on, he will likely do so by alleging that he has lost profits owing to the imposition of the inappropriate tax. If that is the case, then one must consider the claimant’s pricing methods in the operation of his business, as well as the following scenarios:

First, one must recognise that, in estimating the “extent of the lost profits”, the lost profits are equal to the difference between the profits

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32 Ibid.
33 In the context of competition law, the discussion of the defence of passing on (which was nevertheless acknowledged, and the amount of recovery reduced) see the recent English case Sainsbury’s supra note 12 paras 432–437; 472–478 and 480–484. This case was referred to the Competition Tribunal from the High Court.
34 The discussion on pricing methods amenable to passing on is generally the mark-up pricing, which various industries routinely use. See also HJ Hovenkamp. 1990. “The indirect purchaser rule and the cost-plus sales”. *Harvard Law Review*, 103:1717 for a related discussion.
actually earned and the profits that would have been earned “but for” the imposition of the inappropriate tax.\textsuperscript{35}

Secondly, where the alleged “inappropriate” tax was by its nature supposed to have been absorbed by the claimant and not to be passed on to consumers, but the claimant nevertheless overcharged them, these consumers as the ultimate taxpayers may have paid in excess of the unabsorbed portion of the initial value of the inappropriate tax if the claimant used a percentage mark-up pricing system that magnified the said tax to the ultimate consumers.\textsuperscript{36} In such cases, allowing an unqualified tax recovery has the potential of duplicating the award because the claimant may be seeking to recover from a “loss” (or an injury) actually fully borne by another person. The claimant might have recouped fully its losses either through “backward-shifting” or “forward-shifting” and now wants to recover them again from the government by an enrichment action. So, denying a passing-on defence to the government opens the doors to claimants being ingeniously awarded duplicative recoveries.

Thirdly, in most (if not all) cases in which the claimant might dispute the extent of passing on, what will come to the fore is, in effect, a situation akin to apportionment of damages. For the claimant to prove its part of “losses suffered” it must produce evidence of such a loss or “injury” to the business as a result of the imposed tax. This evidence must be reasonably clear or reasonably inferred, even if based on estimates. That is so because a reasonable inference differs from mere speculation. Admissible damage estimates must be more than a stab in the dark. The onus of proving the actual loss or injury to the business or of making a reasonable inference of such loss falls to the claimant as it is the only party in a position to


\textsuperscript{36} Berger & Bergstein op cit note 29 at 862.
do so. 37 Lost profits (or damage) estimates will be deemed insufficient as a matter of law, and therefore inadmissible, if they are the product of mere speculation and guesswork. 38 Because judges cannot be asked to speculate, insufficient “damage” or “injury” evidence cannot be put before the judge.

Fourthly, one should also recognise that the difficulties of estimating lost profits (or other variables) are no worse than those associated with estimating overcharge. For the latter, one must establish the price actually paid, which is usually available from normal business records. 39 This actual price is compared to the price that would have been paid “but for” the “imposition of the inappropriate tax” — in the same way that it happens in competition law for the “price-fixing” claims. 40 The “but for” price is the price that unimpeded forces of supply and demand would have produced. However, one must admit here, as it was explained already elsewhere, that to achieve a satisfactory result the estimation must take into account a variety of economic and “demographic” 41 factors that influence supply and demand. This effort is not likely to be completely successful, therefore

37 See McKesson v Division of Alcoholic Beverages 496 U.S. 31; 110 L.Ed, 2d 17 (1990) at 43. “Because it is the taxpayer and not the [Revenue] Commissioner, that understands the intricacies of the taxpayer’s industry and is in possession of the sales data to establish such a thing as pass through and diminished market share”. In the same vein, Judge Neel of the Supreme Court of West Virginia, in State of West Virginia (Dept of Tax & Revenue) v Exxon Corporation [(1993) case No 21573 – January 1993 Term], granting a writ of prohibition in favour of the state in a similar situation, had this to say:

West Virginia will compensate taxpayers only for the amount of the tax they absorbed and did not pass through to consumers and for any loss of market share attributable to the unconstitutional tax. Claimants should be prepared to furnish this kind of information in order to show the amount of the unconstitutional tax they absorbed and the market share they lost as a result of unconstitutional tax. The amount of tax absorbed is determined by a Tax Incidence Analysis. The focus of this analysis is the relationship between the elasticity of demand and the elasticity of supply as well as the relationship among input costs, revenues, taxes and product prices.

In this case, the state had sought a writ of prohibition to prevent the Circuit Court of Kanawha County from entertaining a declaratory judgment action to settle a dispute between Exxon and the Tax Department. Exxon asked the Circuit Court to declare “Administrative Notice 91-15”, which described as unconstitutional the procedure that Exxon had to follow to obtain a tax refund because the US Supreme Court had already held that states in case of tax refunds had to afford the claimant a meaningful relief, which entailed paying the unconstitutional tax retroactively. 38 For example, in a similar fact scenario other American cases such as Home Placements Service Inc v Providence Journal Co 819 F. 2d 1199, 1205 (First Cir. 1987) have found that “damages awarded according to the lost-profit measure” are inappropriate where the claimant “has introduced no evidence tending to establish comparability between its own business and other companies engaged in similar business pursuits”.


40 Blair & Harrison op cit note 35 at 38.

41 By “demographic factors” here I mean such things as the “nature” of buyers, whether low-income, middle-income or high-income earners; the importance of the product or service traded to the buyers such as whether it is something the buyers by their nature, culture, taste and inclination, etc can live with or without, thereby influencing the level of its demand and supply.
some degree of imprecision will infect the estimation of the “but for” price.

Fifthly, to avoid having a “damage” or “injury” estimate characterised as speculative, certain steps must be taken. For one thing, a plaintiff claiming lost profits during the alleged “damage period” should have a history of profitable operations in the past. In estimating what the profits would have been “but for” the tax imposition (like in an antitrust violation), the claimant must consider other factors that would have influenced the profits during the “damage period”. Some factors – growth, enhanced efficiencies and reduction in competition – may have caused profits to rise, while other factors – such as increased costs, increased competition or regulatory changes – may have caused profits to fall. Accounting for every potential influence may not be possible, but the most important components should be examined.

These suggestions may seem too technical, adding further complexity and not helping at all to simplify the administration of justice in cases of this nature, especially where expediency in tax refunds should be the rule. However, South Africa’s legal system is procedurally equipped to use expert evidence in appropriate cases. This area might be one in which experts may be useful to help the courts determine the extent of passing on where the claimant pleads that it did not fully pass on the tax because of various factors affecting the business. The outcome can be much more reasonable than the outright “no defence” approach. As the onus of proof in showing that it did not fully pass on the tax is on the claimant, he will also be equipped to access this evidence.

In short, despite some apprehension, I am of the view that we may cautiously admit a qualified form of passing-on defence in the South African law of unjustified enrichment in cases of “inappropriate tax” demands if a full refund would indirectly “overcompensate” or compensate twice the claimant after recouping its losses. This result would be inequitable and infringe the very purpose of an unjustified enrichment claim.

This suggestion is merely an exploratory road map and its possible implementation is subject to the legal system maintaining its current “mirror-image loss-gain” in the unjustified enrichment doctrine as a whole, for if that relation is altered, the whole suggestion falls away.

In summary, where there has been an inappropriately charged tax due to the unconstitutionality or illegality of the imposing legislation or norm, the claimant has a prima facie right to recover in full the tax so paid. However, this right may be partially or entirely curtailed and the claimant denied restitution or the extent of recovery diminished if there are compelling policy considerations to do so and the evidence clearly points to curtailing such prima facie right in the following scenarios:

42 Blair & Harrison op cit note 35 at 37.
(i) Where the tax was not meant to be passed on because of its nature and purpose, but had to be borne by the claimant, and the claimant nevertheless passed it on directly or indirectly to the consumers as higher prices or otherwise, such as through “back-shifting” or other mechanisms, the right to recover the said tax may be diminished according to the extent of the loss, or it may be extinguished altogether if losses have been fully recouped.

(ii) In the assessment of the extent of the loss, the court must remain objective and first ascertain the nature of the tax at issue, the pricing mechanism used by the claimant and any other relevant factors.

(iii) The claimant bears the onus of proof and must supply such evidence when alleging that it has suffered loss as a result of the imposition of the tax in question.

(iv) Miscalculation or error in the computation of the tax either by the South African Revenue Service or by the claimant cannot be invoked for any form of passing on.

Where the case does not lend itself to percentage mark-up pricing, the problems of proof may be more difficult. In each case, however, the court should enquire into those problems to determine whether proof of passing on is indeed infeasible. Only then does the conflict between the positive and countervailing policies become irreconcilable. In these circumstances it may be appropriate to preclude a passing-on defence in order to ensure that the principle of legality is not undermined.

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43 Slightly contrary to this proposition would be the European Union which to some extent holds that “any requirement of proof which has the effect of making it virtually impossible or extremely difficult to secure the repayment of charges levied contrary to Community law would be incompatible with Community law”. See Amministrazione delle Finanze dello Stato v SpA San Giorgio (case 199/82 1983 ECR 3595 par. 13); see also Visser 2008 op cit note 3 at 748 note 248; Baines v Commissioner for her Majesty’s Taxes 2005 EWHC 2300 (Ch) para 6. But these observations are only relevant if it is extremely difficult to adduce the evidence, which is not the case if “mark-up pricing” was indeed used.

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