

# Settling municipal debts

## PREFERENCE IN THE CASE OF INSOLVENCY



*City of Johannesburg v Kaplan* NO  
[2006] SCA 45 (RSA) (unreported)

In March 2006, the Supreme Court of Appeal (SCA) handed down a decision that sets an important precedent in respect of the preference given to municipal debts in cases of insolvency, in terms of section 118 of the Municipal Systems Act.

### Issue

At issue was the interpretation of section 118(2), which subjects the provisions of section 118 as a whole to section 89 of the Insolvency Act. The First Respondent was the liquidator of Krokpark CC, which had been wound up and was the registered owner of an immovable property. The Second Respondent, First National Mortgages Nominees (Pty) Ltd. (First National), was the holder of a participation mortgage bond over the immovable property.

The insolvent estate was indebted to the City of Johannesburg for certain municipal debts.

### Legal framework

In terms of section 89(4) of the Insolvency Act, a trustee of an insolvent estate is not barred from transferring immovable property for purpose of liquidating the estate if he has paid the tax on that property in respect of any period not exceeding two years before the date of sequestration. Importantly, claims for taxes in respect of any other period enjoy no preference.

In terms of section 118(1) of the Systems Act, transfer of immovable property requires a certificate from the municipality to the effect that all municipal debts that were due in the two years

## Key points

- Once there is an insolvency or liquidation, a municipality's preference trumps that of a mortgage bond holder only in respect of taxes that became due less than two years previously.
- This limitation only applies with regard to a claim for a 'tax' as defined in section 89(5) of the Insolvency Act.
- Those municipal debts that are not 'taxes' enjoy preference over any mortgage bond on the property.

preceding the date of the application for the certificate have been paid for.

Section 118(3) creates additional protection for municipalities by providing that municipal debts are a charge on the property and enjoy preference over any mortgage bond registered against it. Amounts due for municipal debts are therefore secured by the immovable property. If they are not paid and an appropriate order of court is obtained, the property may be sold in execution and the proceeds may be used to pay the municipal debts.

Only after the municipal debts have been paid is the remainder, if any, available for payment of the mortgage bond.

The lower court held that the abovementioned two-year limit imposed in section 118(1) of the Systems Act also applies to municipal debts secured under section 118(3). The City of Johannesburg was therefore barred from claiming preference beyond the two-year period.

The SCA found in another matter, before deciding the Kaplan case, that the two-year limit does *not* apply to such

security under section 118(3), which is of obvious benefit to municipalities.

## Decision

The SCA agreed with First National that, once there is an insolvency or liquidation, a municipality's preference trumps that of a mortgage bond holder. It is based on the words "*no preference shall be accorded to any claim for such a tax in respect of any other period*" i.e. a period *exceeding* two years immediately preceding the date of sequestration.

The court noted, though, that the two-year limit differs from that which applies in terms of section 118(1), being two years immediately prior to the date of insolvency, as opposed to two years preceding the date of application for a clearance certificate.

Although this limits a municipality's rights of preference in terms of section 118(3) of the Systems Act on insolvency, the two-year limit that applies to such rights of preference only applies to a claim for a 'tax' as defined in section 89(5) of the Insolvency Act.

After sequestration or liquidation, those municipal debts that are not ‘taxes’ continue to attract the benefits of section 118(3) of the Systems Act without being affected by the two-year limit.

No evidence was led on whether the amounts which the City of Johannesburg alleged were owing as municipal debts all constituted ‘taxes’, in terms of which such taxes are amounts that are ‘periodically payable’ in respect of immovable property and in respect of which the liability to pay them is ‘an incident of ownership’.

The Court’s view was that property rates are such a tax but that service charges which are a *quid pro quo* for a measured consumption are probably not. The status of the City of Johannesburg’s other claims thus remained unclear and may be affected by local by-laws or regulations which govern them.

The Court therefore granted declaratory relief and left the issues in respect of which of the debts constituted ‘taxes’ within the meaning of section 89(5) of the Insolvency Act to be resolved by the parties.

## Comment

Although the preference enjoyed by municipalities over that of a mortgage bond holder in respect of municipal debts is limited to two years in circumstances of insolvency, (prior to the date of sequestration), such limitation only applies to ‘taxes’.

There may well be future litigation on the meaning of ‘taxes’ under section 89(5) of the Insolvency Act in the context of section 118(3) of the Municipal Systems Act.



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