IN THE HIGH COURT OF SOUTH AFRICA
CAPE OF GOOD HOPE PROVINCIAL DIVISION

CASE NO A 916/01

In the matter between

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE Appellant

and

WILCOX SWEETS (PTY) LTD Respondent

JUDGMENT DELIVERED ON 20 AUGUST 2002

BLIGNAULT J:

[1] Respondent is a company that carries on business as a manufacturer of sweets. It is a subsidiary of Warner Lambert SA (Pty) Ltd ("Warner Lambert") and it sells all its products to Warner Lambert for distribution by it.

[2] During its year of assessment that ended on the last day of November 1992 respondent moved its manufacturing operations from Johannesburg to Cape Town. In the course of this relocation respondent incurred expenditure which included redundancy

expenses in respect of employees that were retrenched in the amount of R1 124 955,00 and relocation expenses in respect of employees that moved to Cape Town in the amount of R663 964,00.

[3] Respondent sought to deduct these expenses from its income but appellant disallowed them on the grounds that they were of a capital nature and he issued an assessment to respondent on that basis for the tax year ending 30 November 1992. Respondent lodged an objection and an appeal against that assessment.

[4] The appeal was heard by Traverso DJP and two assessors in the Cape Income Tax Special Court ("the Special Court"). In a judgment handed down on 19 June 2000 the Special Court upheld the appeal and sent the assessment back to appellant for re-assesment. Appellant thereupon noted this appeal to a Full Court of this Division against the whole of the judgment and order of the Special Court.

[5] At the hearing in the Special Court Mr Roy Hugh Langley testified on behalf of respondent. At the material time he was the

financial director of Warner Lambert and a director of respondent. Prior to the move to Cape Town respondent manufactured confectionary products in rented premises in Booysens in Johannesburg where it had been for a number of years. These premises were old and double-storeyed. Manufacturing took place on the first floor of the premises and raw materials and finished supplies were stored on the ground floor. There was only one lift in the building and this caused bottlenecks in the production process. The finished products were housed a couple of kilometres away from the plant which caused logistical problems. A decision was then made to move the entire operation to Cape Town. The reasons for this were the unsuitability of the plant in Johannesburg; the logistical problems referred to; the fact that respondent was experiencing problems with the Johannesburg Municipality with regard to effluent that was being released into the sewerage system; and the fact that security had become an ever increasing problem in that particular area. Warner Lambert already had a pharmaceutical plant in Cape Town with spare land adjacent to it. It was accordingly decided to erect respondent's plant on this land. This enabled respondent to share some services with the Warner Lambert pharmaceutical plant.

[6] Respondent offered all its employees the opportunity of relocating to Cape Town. It wanted to retain their expertise and their experience. Those who elected not to move were retrenched and paid a retrenchment package. Respondent had about one hundred and ten (110) employees in Johannesburg. Seventy (70) of them were members of a trade union. Only eight (8) employees elected to move to Cape Town. All of them but one were employed in managerial positions. Their removal expenses and hotel accommodation were paid for a period of up to three months, as well as one month's salary as a settling in allowance.

[7] Respondent's remaining employees were retrenched. Respondent had an existing recognition agreement with the trade union which provided *inter alia* for the eventuality of retrenchments. It was indeed part of the whole group's policy to provide for the payment of retrenchment packages in the event of retrenchments. Respondent also had a written policy in its employees' manual which dealt with retrenchments. Following its decision to relocate respondent negotiated with the trade union and with the non-union members in regard to the retrenchments and a retrenchment

agreement was arrived at with all in June 1992. This agreement provided for the payment to or on behalf of the employees of the relevant amounts now claimed as deductions.

[8] The Special Court held that the expenditure in question was deductible in terms of section 11(a) of the Income Tax Act 58 of 1962, as amended. In terms of that section a taxpayer is allowed to deduct from income *"expenditure and losses actually incurred in the Republic in the production of the income, provided such expenditure and losses are not of a capital nature"*. In her judgment Traverso DJP referred with approval to the following passage in the judgment of Scott J in **COMMISSIONER FOR INLAND REVENUE v VRD INVESTMENTS (PTY) LTD** 1993 (4) SA 330 (C) at 340 C-D:

> *"Expenditure incurred in order to operate a business 'on more economical lines' or in a manner which is 'more efficient' is of a revenue rather than a capital nature, provided that the expenditure is sufficiently closely connected to the income-earning operation of the business as to be regarded as part of*

> *the cost of performing it (cf Secretary for Inland Revenue v John Cullum Construction Co (Pty) Ltd 1965 (4) SA 697 (A) at 714; Port Elizabeth Electric Tramway Co Ltd v Commissioner for Inland Revenue 1936 CPD 241 at 246)."*

Traverso DJP also found support in the judgment of Tredgold CJ in **PROVIDER v COMMISSIONER OF TAXES** 1950 (4) SA 289 (SR). That case was concerned with the deductibility of benefits paid by a commercial undertaking that had, under a non-contributory and voluntary scheme, undertaken to pay benefits to the dependants of employees who died in their service. The court held that the amounts so paid could be deducted for income tax purposes. In the course of his judgment Tredgold CJ said the following at 290 B-D:

> *"Now the motives with which the schemes were introduced may have been somewhat mixed, but their main purpose is clear. The company is a commercial undertaking and not a philanthropic institution, and the whole tenour of the schemes makes it clear that they are designed to secure a contented staff, giving long and continuous service, with the benefits to*

production which must follow such conditions. They are closely analagous to the annual bonuses and other deferred emoluments which are clearly allowable for income tax purposes."

[10] Traverso DJP held that the employment of employees was essential to the performance of respondent's income-earning operations and it was this employment of employees that necessitated the expenditure in question. She also pointed out that inasmuch as employees do not constitute a capital asset in a business, the relocation expenses incurred in respect of the "removal" of employees cannot be expenditure of a capital nature.

[11] Mr van Rooyen appeared on behalf of appellant in the appeal. He submitted that the expenses in this matter were incurred once and for all and with the view to bringing into existence an advantage for the enduring benefit of the trade of respondent. He relied in this regard upon the following reference by Clayden CJ in **NCHANGA CONSOLIDATED COPPER MINES LTD v COMMISSIONER OF TAXES** 1962 (1) SA 381 (FC) at 387 H to an often quoted passage

from **BRITISH INSULATED & HELSBY CABLES LTD v ATHERTON** 1926 A.C. 205:

> *"The well accepted dictum at pp. 213 - 4 reads:*
>
> > *'But when an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, I think that there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such expenditure as attributable not to revenue but to capital.'*
>
> *That is a passage of great authority, and much accepted."*

Respondent, Mr van Rooyen submitted, incurred the expenses in question in the course of creating an income-producing structure in Cape Town. The court a quo erred, he submitted, in equating the removal of employees to the removal of trading stock. When stock in trade is moved it is normally done with a view to disposing of it at a

profit. There is no similarity, he submitted, between the expenditure and the remuneration ordinarily paid to employees for services rendered by them. The expenditure in this case, he submitted, was incurred to facilitate the relocation of respondent's plant from Johannesburg to Cape Town. It was accordingly incurred to establish an income producing structure in Cape Town.

[12] Mr Emslie appeared on behalf of respondent. He submitted that the proper test is to be found in the following passage in the judgment of Watermeyer CJ in **NEW STATE AREAS LTD v COMMISSIONER FOR INLAND REVENUE** 1946 AD 610 at 627:

> *"The conclusion to be drawn from all of these cases, seems to be, that the true nature of each transaction must be enquired into in order to determine whether the expenditure attached to it is capital or revenue expenditure. Its true nature is a matter of fact and the purpose of the expenditure is an important factor; if it is incurred for the purpose of acquiring a capital asset for the business, it is capital expenditure, even if it is paid in annual instalments; if, on the other hand, it is in truth no more than part*

of the cost incidental to the performance of the income-producing operations, as distinguished from the equipment of the income-producing machine, then it is revenue expenditure, even if it is paid in a lump sum."

In the present case, Mr Emslie submitted, although the expenditure in question was occasioned by respondent's move to Cape Town, both its purpose and its effect were on the one hand to compensate employees for the expense and inconvenience entailed by the move and on the other to compensate employees for their loss of employment. The move was prompted by ordinary considerations of efficiency and cost-effectiveness and as such the expenditure associated with the move was clearly incurred in the production of income. In support of his submissions Mr Emslie relied, *inter alia*, on the judgment in the **PROVIDER** case, referred to above, and the following statement in **SECRETARY FOR INLAND REVENUE** v **JOHN CULLUM CONSTRUCTION CO (PTY) LTD** 1965 (4) SA 697 (A) at 714:

"The actual facts are of course extra-ordinarily similar in essence to those in the Anglo-Persian Oil case [Anglo-Persian Oil Co. Ltd v Dale, (1932) 1 K.B. 124; 16 T.C. 253]. *As in that case the object of the payment was to get rid of a contract which had become an undue burden. The respondent in reality intended to do no more than put itself in a position to conduct its business on more economical lines. The payment brought it no asset of any nature, it enhanced no asset and it preserved no asset. The respondent received the temporary benefit of being free to attempt to obtain better terms upon which it could arrange finance for customers requiring assistance in the purchase of houses built by the company. It might or might not have succeeded in obtaining such better arrangements. But this temporary benefit could never be said to be an asset of a capital nature in that it was 'an advantage for the enduring benefit of the trade'. The R16,000 could not be found converted into an enhanced or maintained portion of the capital income producing structure of the company. In such circumstances it was not expenditure of a capital nature."*

[12] I propose to deal first with the question of the retrenchment payments. As these payments were made in 1992 it is necessary to have regard to the legal position under the Labour Relations Act 28 of 1956 which applied at that time. That Act did not contain any specific provision dealing with an employer's obligation to make retrenchment payments. The matter was governed by the unfair labour practice jurisdiction of the then industrial courts. The legal position in regard to severance pay was summarized in **LAWSA Vol 13 para 431**, stating the law as at 31 July 1994, as follows:

> *"**Severance pay** During the past number of years there has been much controversy and uncertainty regarding the question whether an employer is entitled to refuse to pay severance pay to an employee to compensate for losses which he suffered through retrenchment or redundancy.*
>
> *The labour appeal court decided in 1991 that an employee had no such entitlement to severance pay, but that such pay could be negotiated between the parties. This approach, however, was endorsed with qualifications when it was decided that, if*

the employer is financially in a position so to do, he is indeed under an obligation to pay severance benefits to employees. It has, however, now been decided and can be accepted as settled law that an employee is entitled to severance pay."

[13] It is clear from the evidence that at the time of the retrenchments in 1992, respondent was under a contractual obligation to pay retrenchment packages to those employees who were members of the trade union. These employees would have been able to rely on the specific provision in the recognition agreement which provided for severance benefits. In regard to the employees who did not belong to the trade union there was a policy document which formed part of the employees' manual and which promised similar benefits. From a practical point of view respondent would have been obliged to honour the terms of this policy document as its failure to do so would in all probability have been regarded as an unfair labour practice. As a matter of fact respondent did give effect to these terms. Union members and non-union members were treated equally. It seems to me therefore that in making these retrenchment payments respondent was giving effect to its pre-

existing contractual obligations to its employees. As such there can be no doubt in my view that the payments were made in the production of income.

[14] As to the relocation expenses paid to the employees who elected to move to Cape Town, it seems to me that the passage in the judgment in the **PROVIDER** case, quoted above, is in point. Although respondent was not under any strict legal obligation to pay these costs they were paid by it as an inducement to the employees to remain in its employment. Respondent wanted to retain their experience and expertise.

[15] The judgment of Ogilvie Thompson JA in **L FELDMAN LTD v SECRETARY FOR INLAND REVENUE** 1969 (3) SA 424 (A) is also instructive. In that case the deductibility, in terms of section 11(a) of the Act, of an amount paid by the appellant to the widow of its managing director, was in issue. The Appellate Division held that as no finding had been made by the Special Court concerning the intention which had motivated the company in making the payment, the matter should be remitted to it to enable it to make such a finding.

The relevant resolution in that case read as follows:

> *'The then directors considered that the appellant company's pension scheme provided inadequate benefits in the event of their deaths for their widows and that provision should be made for some form of additional benefits to them by the appellant company.'*

On behalf of the Secretary for Inland Revenue it was argued that the payments contemplated by the resolution were directed, not to the future earning activities of appellant company, but towards promoting the financial security of the widows of the directors named in the resolution. In his judgment Ogilvie Thompson JA discussed the appellant's contention as follows (at 434E – 435B):-

> *"It was submitted on behalf of appellant that the above facts suffice to establish, on a balance of probabilities, that the R4,800 in issue was an expenditure incurred in the production of appellant's income and that this Court should so hold. In developing that over-all submission, counsel for appellant, with mention of the principles, set out in Parke v Daily News Ltd.,*

1962 Ch. 927, of English Law governing the disposition of company funds, argued that, on the above facts, this Court must assume that appellant acted entirely intra vires, that is to say, in the interests of appellant company itself, as distinct from the interests of the directors or their widows. Pointing out that the joint managing directors were full-time employees of the appellant, and rightly emphasising that, in terms of the resolution of 5th April, 1957, a widow can only benefit if her husband was at the date of his death, 'in the employ of the company', counsel for appellant argued that the benefits conferred by the resolution were, despite its wording, predominantly in respect of future services to be rendered by the directors subsequent to 5th April, 1957; and, further, that the resolution, being an inducement to the directors to remain in the service of appellant, was designed to promote the interests of the company by providing an additional incentive for long, continuous and efficient services on the part of its directors. Payments made pursuant to the resolution are, said counsel for appellant, in the nature of deferred remuneration, paid as a normal expense of running the company, for services to be

rendered by an employee and, as such, the payment in issue was expenditure incurred for the purpose of earning income (Sub-Nigel Ltd v C.I.R., 1948 (4) SA 580 (AD) at p. 592).

These submissions are not without considerable force. Had the benefits provided by the resolution of 5th April, 1957 constituted part of an initial contract to render services to appellant, the case for deduction would manifestly have been much stronger. I must not be understood as in any way suggesting that, because the resolution of 5th April, 1957 was passed in relation to directors who already held office, that necessarily concludes the matter against deductibility. But the circumstance that the payments in issue did not derive from a term of initial engagement leaves room for the contention that the obligation to make such payments was undertaken, not in the interests of the company, but in the interests of the named directors' widows."

Ogilvie Thompson JA then gave the following reasons for remitting the matter to the Special Court (at 435D – G):-

"To be deductible, the expenditure in issue must, as mentioned earlier in this judgment, have been incurred 'in the production of the income' of the taxpayer and wholly or exclusively 'for the purposes of trade' (secs. 11 (a) and 23 (g)). One of the material factors to be determined in that over-all enquiry is the intention with which the obligation to make the payments claimed for deduction was undertaken (cf. Re Lee Behrens & Co. Ltd., (1932) 2 Ch. 46 at pp. 51 - 52). What that intention was is a question of fact, and questions of fact must ordinarily be determined, not by this Court, but by the Special Court. It is conceivable that the issue of intention was actually ventilated before the Special Court but, if that be the case, the evidence is not before us and as already mentioned, neither the stated case nor the judgment of the Special Court contains any express finding on the important question of intention. In the absence of any such finding, this Court should, in my judgment, not, as urged upon us by counsel for appellant, now decide the issue between the parties merely by way of inference from the facts presently before us.

In all the circumstances, I am of opinion that justice will best be done by remitting the case to the Special Court for further consideration in the light of what has been stated in this judgment."

[16] It seems clear from the judgment of Ogilvie Thompson JA that the expenses in question in that case would have been regarded by the Appellate Division as deductible if they had been found to have been incurred, as was suggested by the appellant, for the purposes of the company by providing an additional incentive for long continuous and efficient services on the part of the directors. In my view that purpose is substantially similar to respondent's motivation, in the present case, in paying the relocation expenses. This judgment is accordingly authority for the conclusion, in this case, that the relocation expenses were incurred by respondent in the production of income.

[17] I do not agree with appellant's submission in this case that any of the retrenchment or relocation expenses were incurred for

purposes of creating an income-producing structure in Cape Town. Respondent's relocation from Johannesburg to Cape Town might have been the initial cause which gave rise to the incurring of these expenses in the sense that they would not have been incurred had the move not taken place. That does not mean, however, that the expenses were incurred for that purpose. The retrenchment expenses were paid because respondent was contractually obliged to do so. The relocation expenses were incurred for the purpose of retaining the experience and expertise of its employees. All these expenses were in my view sufficiently closely connected with respondent's income-producing operations to qualify as revenue expenditure. I similarly do not agree with appellant's submission in this case that these expenses created an "advantage for the enduring benefit" of respondent's trade. Respondent did not acquire any asset by paying the retrenchment expenses or the relocation expenses. Nor did it in that process enhance or improve any of its assets.

[18] I am accordingly of the view that respondent's appeal to the Special Court was correctly upheld in that court. I would dismiss appellant's appeal to this court with costs. The quantum of

respondent's expenses was never in issue. In order to avoid any possible uncertainty I would amend the order of the Special Court to read as follows:

> *"The appeal is upheld and the assessment is remitted to respondent for re-assessment. In making such re-assessment respondent is directed to allow appellant's expenses of R1 124 955,00 for retrenchment costs and R663 964,00 for relocation costs as deductions."*

A P BLIGNAULT

HLOPHE JP: I agree. It is so ordered.

J M HLOPHE

FOXCROFT J: I agree.

J G FOXCROFT