IN THE HIGH COURT OF SOUTH AFRICA
(ORANGE FREE STATE PROVINCIAL DIVISION)

Appeal No: A264/2006

In the appeal between:

W J FOURIE BELEGGINGS CC Appellant

and

COMMISIONER OF THE SOUTH AFRICAN REVENUE SERVICES Respondent

CORAM: **HATTINGH, J *et* VAN DER MERWE, J *et* C.J. MUSI, J**

JUDGMENT: C.J. MUSI, J

DATE HEARD: 6 AUGUST 2007

DATE DELIVERED: 27 SEPTEMBER 2007

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[1] The appellant taxpayer, W J Fourie Beleggings CC, appeals under section 86 A(1) read with section 86 (2) (a) of the Income Tax Act 58 of 1962 (the Act), against the decision of the Free State Income Tax Special Court.

[2] The question that falls to be decided in this appeal is whether an amount of R1292 760.00 which was paid to the appellant, during the year of assessment ending 28 February 2002,

pursuant to a settlement agreement was a capital receipt and therefore non taxable or a revenue receipt, which is taxable.

[3] The appellant is the lessee of the Elgro Hotel at Potchefstroom. The owner/lessor is Bultfontein Eiendomme Beleggings (Edms) Bpk. On 4 April 2001 Naschem, a division of Denel (Pty) Ltd, requested the appellant to provide accommodation and meals for students from the United Arab Emirates (UAE) who were to be trained by Naschem in South Africa. The appellant agreed. Thirty eight students were to be accommodated and supplied with meals from 1 April 2001 for 791 days. Twelve students were to stay from 1 April 2001 to 6 May 2001 (36 days); seventeen were to stay from 1 April 2001 to 30 September 2001(183 days); eighteen were to stay from 1 April 2001 to 30 September 2001(183 days). Meals were also to be provided for five officers from 1 April 2001 to 30 September 2001. The total value of the contract was R 8 791 913.70.

[4] A few days after the attack on, inter alia, the twin towers in New York (United States of America) on 11 September 2001 the students left the Elgro Hotel without any rhyme or reason. The appellant viewed their conduct as a breach of

the agreement. After the appellant threatened to sue Naschem the parties agreed to settle the matter out of court.

[5] On 6 December 2001 they inter alia agreed to the following terms:

> "1. SKIKKINGSBETALING:
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> Naschem onderneem om 'n bedrag van R1 292 760.00 (Een miljoen twee honderd, twee en negentig duisend sewehonderd en sestig rand) BTW ingesluit aan ELGRO HOTEL, te betaal in volle en finale vereffening van alle eise, van welke aard ookal, wat ELGRO HOTEL teen (hom) mag hê, ongeag of dit spruit uit die kontraktereg, of ingevolge die Gemenereg.
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> 2. AFSTANDDOENING VAN REGTE:
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> As teenprestasie vir die betaling van bogenoemde skikkingsbedrag, onderneem ELGRO HOTEL om:
>
> 2.1 alle regte wat hy mag hê op skadevergoeding te abandoneer, en
>
> 2.2 enige hangende – of beoogde hofaksie teen NASCHEM te laat vaar."

Naschem paid the money to the appellant.

[6] The appellant called two witnesses viz Ms Gerber – a legal advisor and member of the executive committee of Naschem - and Mr Fourie, the sole member of the appellant.

[7] Ms Gerber, an admitted attorney, confirmed the existence of the agreement between Naschem and the appellant. She also confirmed that the students left the Elgro Hotel without notice. After she heard about their departure from the appellant's hotel she contacted an attorney to seek legal advice. She and the attorney agreed that the best course of action would be to try and settle the matter out of court in order to save litigation costs, avoid being exposed to a claim for damages and to retain the business relationship with the appellant.

[8] Naschem offered the appellant R600 000.00 which was rejected. The appellant proposed R 1.2 million. The proposal was accepted on condition, inter alia, that the appellant should waive its right to institute any claim against Naschem as a result of the students' actions. According to her, approximately two-thirds of the Elgro Hotel was occupied by students from the UAE. As a result, the appellant lost a lot of clients. The students also caused

extensive damage to the rooms. She does not know how the amount that was ultimately paid was computed. Her brief was to get the appellant off their backs and to settle the matter out of court by keeping the settlement amount as low as possible. The money paid to the appellant was therefore meant as a settlement to get it off their backs and to retain the good business relationship that Naschem had with the appellant. She conceded that the 2001 contract between Naschem and the appellant had no terms in relation to renovations that had to be done to the hotel.

[9] Mr Fourie testified that he is the sole member of the appellant. The Elgro Hotel is leased by the appellant. He confirmed the accommodation and catering contract that the appellant had with Naschem. According to him the appellant had to effect many changes to the hotel in order to secure the contract. Those changes were done prior to the tax year that is relevant to these proceedings. The appellant also employed specialist personnel to look after the dietary requirements of the students. The hotel was doing good business before the contract with Naschem. It could accommodate up to 25 conferences per week. On entering the contract with Naschem 70% of the hotel was occupied by

the UAE students. The students occupied all the double rooms and only single rooms were available for other guests. Days after the 11 September 2001 attack in the USA the students left the hotel. There was still R4.7 million outstanding on the contract. After the students moved out they saw that the rooms in which they were staying were wrecked. The carpets were burned, the mattrasses had holes, the furniture was damaged and the walls were dirty. He estimated that the repair costs would be in the region of R1.2 million. He settled the matter to repair the rooms so that he could – as soon as possible-continue with his business. Initially he testified that he did not know how the settlement amount was computed. He later stated that the settlement amount included repair costs as well as operating, or running costs (salaries), water and lights etc. During cross examination the turnover, expenses and repair costs for the years 1998 to 2004 of the hostel was put to him. He also conceded that the appellant used approximately R1 million of the money; ± R500 000.00 to repay a loan and ±500 000.00 towards trade debts. He later – during re-examination - testified that the amount was computed as follows: R1.1 million plus vat for damages and R34 000.00 for legal fees and services rendered.

[10] The factual findings as well as the legal conclusions of the Court a quo were challenged by Mr Van Breda on behalf of the appellant. The nub of his argument was that the Special Court should – on the facts – have found that the amount received by the appellant was a capital receipt and not a revenue receipt. Mr Stevens on behalf of the respondent contended that the Court a quo was correct in finding that the settlement amount was a surrogatum for future profits surrendered.

[11] The Court a quo did not actually make any credibility findings in relation to the witnesses. In the absence of any findings on demeanour and or credibility this Court is at large to make its own factual findings where necessary. See **Hicklin v Secretary For Inland Revenue** 1980 (1) SA 481 (AD) at 485 D – H.

[12] In relation to Ms Gerber the Court a quo said that:

> "(H)aar pogings om te probeer verduidelik dat dit die hele doel van die kontrak was kom neer op 'n oorneem van die funksie van die hof."

This criticism of this witness is unfortunate. Ms Gerber was a party to the negotiations that led to the signing of the settlement agreement. She assisted in the drafting thereof. She also signed it as a witness. Her evidence is – the way I see it – helpful to assist the court in determining what in fact the receipt was actually for. The court must not look at the form of the agreement but its real nature. A court in determining the true character of the receipt must of necessity have regard to all the surrounding circumstances. The court may in particular also have regard to extrinsic evidence to assist it in determining the purpose and sometimes effect of the receipt or expenditure. The court should not be bound by labels that the parties attach to the compensation. It is only after the court has had regard to the full picture that it, not the witnesses, attaches a particular label to the compensation or receipt.[1] It is not always easy to discern from an agreement what a receipt was for. The *tête – a – tête* of the parties might then be of assistance to the court. The intention of the taxpayer or the parties is also relevant to determine what the receipt was for. The intention

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1. See the English decisions: CIR V church Commissioners for England (1976) 50 TC 516 at 538; Burman v Thorn Domestic Appliances (Electrical) Ltd (1981) 55 TC 493 at 507 I. See also ITC number 254 – 7 SATC p 56 at 58.
ITC 1338: 43 SATC 171 at 175.

of the parties is relevant because if the facts show that the amount is *prima facie* of an income nature, the taxpayer may be able to provide an explanation, in person or through witnesses, to rebut the inference that the amount is of an income nature. The explanation of the events, including the intention of the parties to the transaction is therefore relevant. This evidence must be evaluated in the light of all the other objective facts and circumstances.[2]

[13] It is clear from Ms Gerber's evidence that Naschem was under pressure to settle the matter out of court. Naschem wanted the appellant off their backs. The settlement amount was not computed with reference to any damages suffered by the appellant. She testified as follows:

> "Soos ek weer eens vir u sê, dit is nie skade wat ons bereken het nie, dit is bedryfskostes en dit is weer om op die bene te kom dat hy gewone gaste in sy hotel kan ontvang."

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2. See LAWSA First Reissue volume 22 Part 1 page 24 – 25 paragraph 42.

Later during cross examination she testifies as follows:

> "Nou hierdie kontrak op bladsy 36 van die dossier, as daardie kontrak sy volledige tyd uitgeloop het, wat sou gebeur het? Mnr Fourie sou al die inkomste uit Naschem ontvang het wat hy volgens daardie bestelling op geregtig sou wees het. --- Ja, dit is korrek.
>
> Dit is korrek. Nou het die een party het uitgetrek uit die kontrak uit, die studente, Naschem. Is dit met ander woorde korrek dat mnr Fourie sou gesê het hier is nou 'n gaping. Hier is nou 'n gaping in my inkomste en ek wil hê u moet my bietjie help. --- Wel hy het vir ons gesê hier is 'n probleem en hy het regtig hierdie probleem gehad van bedryfskoste van skielik het hy niemand in sy hotel nie.
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> Bedryfskoste, wat bedoel u daarmee? --- Om daaglikse personeel te betaal en net om die hotel aan die gang te hou.
>
> Korrek, dit was sy eintlike probleem. --- Ja.
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> Hy het ingestem dat 'n bedrag van R1.292 miljoen sal voldoende wees as vergoeding. --- Nie as vergoeding nie, as skikking dat hy kan aangaan en dat ons nie 'n hofsaak gaan hê nie."

[14] In my view Ms Gerber was not a dishonest witness neither did she attempt to usurp the Court's powers. She tried, as best as she could, with a slight bias in favour of the appellant, to recall the events giving rise to the signing of the

settlement agreement. Her brief was to keep it as low as possible. Likewise her evidence as to the condition of the hotel after the students moved out should also be ignored because she never inspected the hotel. She was therefore not in a position to testify as to whether the hotel could accommodate ordinary guests.

[15] Mr Fourie could not give a clear and coherent account of what the money was paid for. Neither could he give an acceptable explanation as to how the money was computed. It was only during re-examination after he consulted with his legal representative that he gave an account of how the money was computed.[3] Fourie vacillated to such an extent that the true purpose and effect of the compensation, on his evidence, defies delineation. The money was initially only to effect repairs which he estimated to be in the region of R1.2 million. He then changed tack and said that the compensation was for repairs and to alleviate his cash flow problems. He later conceded that the appellant used approximately R500 000.00 of the money to repay a loan

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3. The consultation took place after the witness was cross-examined. The President correctly pointed out that it is highly irregular to consult with one's witness after cross examination but before re-examination. Such conduct, without the opponent or the court's permission, is irregular and contrary to the rules of the General Bar Council.

and that it used another R500 000.00 to pay off its current liabilities.[4] His evidence would test and find the most credulous person wanting. His evidence should in my view only be accepted with a generous measure of circumspection.

[16] When considering the nature of a compensation receipt the court should seek to answer two fundamental questions, firstly, is the compensation a receipt of the trade? Secondly, if the answer to the first question is yes, is it a capital or a revenue receipt? In casu the appellant alleges that the amount is a receipt of trade and that it is capital. The appellant bears the onus to prove same on a balance of probabilities.[5]

[17] If the answer to the first question is in the negative and it is clear that the compensation arose outside the trade then it cannot be said that the money was received as part of the

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4. Although the purpose for which the compensation was used is strictly speaking irrelevant it can however be relevant to determine the effect of the compensation, which in turn helps to determine what the receipt was actually for.

5. See section 82 of the Act which reads:
"Burden of proof that any amount is –
(a) exempt from or not liable to any tax changeable under this Act; or
(b) subject to any deduction, abatement or set-off in terms of this Act; or
(c) to be disregarded or excluded in terms of the Eighth Schedule,
shall be upon the person claiming such exemption, non-liability, deduction, abatement or set-off, or that such amount must be disregarded or excluded, and upon the

profit making structure of the business. Neither can it be said to be the fruit of the profit making structure. There must therefore be a close connection between the trade being carried on and the cause of the payment of the compensation.[6] In this matter it is clear that the compensation was indeed a receipt of the trade. I now turn to the second question.

[18] Our income tax system rests on the concept of *"gross income."* Generally, receipts or accruals of a capital nature are not calculated as part of a person's gross income.[7] Receipts or accruals of a capital nature are not defined by the legislature. The distinction between receipts of a capital nature and of a revenue nature has been the subject of numerous judicial pronouncements. Marais JA eloquently points out that it is an exercise in futility to endeavour to design a yardstick or test to decide when an expenditure is revenue or capital. He states it thus[8]:

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hearing of any appeal from any decision of the Commissioner, the decision shall not be reversed or altered unless it is shown by the appellant that the decision is wrong." See also ITC 1279:40 SATC 254 at 258.

6. See LAWSA supra page 155 paragraph 263.

7. See definition of gross income in section 1 of the Act.

8. In Rand Mines (Mining & Services) Ltd v CIR 1997 (1) All SA 279 (A) at 285 (i) – 286 (f).

"Yet again this Court is required to label expenditure incurred by a taxpayer as either capital or revenue expenditure. The distinction is clear enough conceptually and by now so familiar that repetition is unnecessary... An abiding problem has been to identify and then synthesise into reasonably accurate and universally applicable yardstick the factors which are indicative of each of the two classes of expenditure. No such yardstick has yet been fashioned and the attempt has come to be regarded as futile and has been abandoned. Instead the courts have identified useful indicia to which regard may be had, emphasising that they are no more than that and that in each case close attention must be given to its particular facts. In Commissioner of Taxes v Nchanga Consolidated Copper Mines Ltd [1964] 1 All ER 208 (PC) at 212, [1964] AC 948 at 959

Lord Radcliffe warned against the notion that any of the indicia identified by the courts, taken singly, will lead to the right conclusion. He said:

> "...all these phrases, as, for instance, 'enduring benefit' or 'capital structure' are essentially descriptive rather than definitive, and, as each new case arises for adjudication and it is sought to reason by analogy from its facts to those of one previously decided, a court's primary duty is to enquire how far a description that was both relevant and significant in one set of circumstances is either

significant or relevant in those which are presently before it.

Nonetheless, courts continue to be regaled with comparisons. Given the absence of a satisfactory litmus test of principle, it is inevitable that casuistic comparisons will be made and they undoubtedly have some value. Greater precision is regrettably simply not attainable when value judgments such as this have to be made"

Although Marais JA was referring to capital and revenue expenditure the quoted passage applies to receipts or accruals as well.

[19] Mr Van Breda and Mr Stevens referred us to a plethora of authorities in favour of or analogous to their respective cases.

[20] The following may be pointed out from those cases. A payment received for the permanent or sometimes temporary loss, deprivation or *"sterilization"* of a capital asset of the business is a capital receipt. Likewise if the payment is made pursuant to a restraint of trade clause that accrual will be of a capital nature. See **Glenboig Union Fireclay Co. Ltd v Commissioner for Inland Revenue** 12 TC 427. **Commissiner for Inland Revenue v Illovo Sugar Estates**

Ltd 1951 (1) SA 306 (N). In contrast it has been pointed out that if the compensation is for some temporary interference with the trader's use of an asset then the accrual is of a revenue nature. See **Burmah Steam Ship Company Ltd v CIR** (1930) 16 TC 67 where it was held that if the compensation is to *"fill a hole"* in the income or profit of the taxpayer it will be regarded as revenue and not capital. In **Bourkes Estate v Commissioner for Inland Revenue** 1991 (1) SA 661 (AD) at 672 A – C Hoexter JA pointed out with reference to **Broomberg Tax Strategy 2nd ed** (1983) at 199 – 200, that the fact that what was plugged is a hole in the assets does not, by itself conclude the inquiry. The passage to **Broomberg's** work reads as follows:

> "Of course, it is not sufficient to establish that the compensation is being paid in order to fill a hole in the taxpayer's assets. It is necessary, in addition, to ascertain the true nature of that asset in the recipient's hands. More particularly, was the asset, prior to its destruction or damage, an asset of a capital nature or was it floating capital? If it was floating capital, such as trading stock, standing crops, or consumable stores (like petrol, oil and so forth) the compensation will, obviously, be of a revenue nature, and will be subject to tax. In short, it is only where the payment received is to fill a hole in the capital assets of the taxpayer that the payment will escape the tax net."

[21] The above *"tests"* are not always helpful when one is dealing with compensation for cancellation of trading contracts. An amount paid by way of damages or compensation takes on the character of the loss in compensation for which it has been paid. If the payment is made in respect of a loss of income, the receipt will be of a revenue nature.[9] A receipt arising on the cancellation or variation of a trade agreement is normally of a revenue nature. Where however a contract is so crucial that its loss would cripple or destroy the business it may transcend the status of an ordinary commercial contract.

Income received for the termination of such a contract may – depending on the facts and circumstances of the particular case – be capital.

[22] In ITC 129: 40 SATC 254 at 258 Coetzee J followed the approach in **IRC v Fleming & Co (Machinery) Ltd.**[10] In the **Fleming** matter Lord Russel said the following:

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9. LAWSA supra page 32 paragraph 46 (b).

10. (1951) 33 TC 57 at 63.

"The sum received by a commercial firm as compensation for the loss sustained by the cancellation of a trading contract or premature termination of an agency agreement may in the recipient's hands be regarded either as a capital receipt or as a trading receipt forming part of the trading profit. It may be difficult to formulate a general principle by reference to which in all cases the correct decision will be arrived at since in each case the question comes to be one of circumstance and degree. When the rights and advantages surrendered on cancellation are such as to destroy or materially to cripple the whole structure of the recipient's profit-making apparatus, involving the serious dislocation of the normal commercial organisation and resulting perhaps in the cutting down of the staff previously required, the recipient of the compensation may properly affirm that the compensation represents the price paid for the loss or sterilisation of a capital asset and is therefore a capital and not a revenue receipt. Illustrations of such cases are to be found in Van den Bergh Ltd 19 TC 390, [1935] AC 431, and Barr, Crombie & Co Ltd 26 TC 406, 1945 SC 271. On the other hand when the benefit surrendered on calculation does not represent the loss of an enduring asset in circumstances such as those above mentioned – where for example the structure of the recipient's business is so fashioned as to absorb the shock as one of the normal incidents to be looked for and where it appears that the compensation received is no more than a surrogatum for the future profits surrendered – the

compensation received is in use to be treated as a revenue receipt and not a capital receipt."

Coetzee J found this approach to be crisp, logical and in sync with our legal principles. I agree.

[23] If it is shown that the cancellation of a commercial contract affected the profit making structure of the business or that it affected the whole manner in which the business is conducted and that compensation has been paid therefore then that compensation would be of a capital nature.[11]

If the amount to be paid is computed with reference to future loss of profits the receipt will remain of a capital nature. The method used to compute the sum therefore does not necessarily determine the nature of the sum.[12]

[24] Mr Van Breda argued that the facts of this matter show that the compensation in this matter was of a capital nature. He emphasised the following factors:

24.1 the long term nature of the contract;

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11. See Taenber & Corssen (Pty) Ltd v Sec for Inland Revenue 1975 (3) SA 649 (AD) at 662 A – D.
12. See ITC 254: 7 SATC 56 p58.

24.2 the unexpired term at cancellation;

24.3 the amount due for the unexpired period;

24.4 the fact that the hotel was going to lose more than two thirds of its occupants;

24.5 the extend of the costs in relation to improvements to the structure in order to secure the contract and the cost of repairing the hotel which is between R1.1 million and R1.2 million;

24.6 the near loss of all regular clients of the hotel.

[25] The court a quo correctly, in my view pointed out that it is very dangerous in income tax matters to move away from the facts of a particular case. An evaluation of the facts devoid of context will always lead to a flawed conclusion. Mr Van Breda's arguments do not take account of the facts of this matter. The capital asset of the appellant is the lease of the hotel itself. The hotel rooms are hired out and those who receive the right to occupy must pay for accommodation and catering. The hotel is put to work by the appellant to generate income.[13]

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13. See Rand Mines (Mining & Services) Ltd v CIR supra at 289 g – h.

The hotel itself is therefore the income/profit producing structure of the appellant. The hotel had 105 rooms. The hotel was not going to be 70% occupied by the students for the full duration of the contract. The contract in respect of the 12 students (1 April 2001 to 6 May 2001) already ran its course. Appellant was to be compensated according to the contract on the 31 August 2001 in respect of all the other students except the 38 that were going to stay for 2 years. There is no evidence to the effect that Naschem did not deliver or pay on the stated delivery date (31 August 2001). In any event when the students moved out in September 2001 it was less than 20 days from the date on which all the other students, except the 38, were to move out permanently. This much is made clear in the contract and to some extend during cross examination of Fourie. He said the following:

> "Ja ek verstaan dit, maar 38 is ver van – die hotel was nie vol met hulle nie, net met die 38 nie. --- Nee, ons het 105 kamers en maksimum was sê maar 70 wat daarna gebly het, maar die hele tydperk was daar, sê 38 maar dan het ons offisiere en goed wat ook bygekom het en hulle het die getal ook opgestoot.
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> Ja, maar as 'n mens kyk na bladsy 36 weer, party van die studente het net vir April en Mei 2001 daar gebly. --- Dit is so, ja.

En daar lyk vir my volgens die inligting daar was daar net 38 studente wat permanent daar sou gebly het vir twee jaar. Die ander het gekom en gaan. --- Daar was twee kontrakte gewees. Die een was vroeër gewees en hierdie is 'n nuwe kontrak en hulle het oorvleuel vir 'n tydperk.

Maar ons het dit nie op rekord nie. --- Nee, ek het nie daardie nommers hier nie.

Is dit inligting op bladsy 36 met ander woorde nie korrek nie?--- Dit is korrek

My vraag aan u is net, u het nie 76 studente geboek vir 'n volle tydperk van twee jaar nie. ---Nee.

U het net 38 studente geboek vir 'n volle tydperk van twee jaar. --- Dit is moeilik om vir u daarop te sê, want deurgaans was daar offisier gewees wat die heeltyd daar gewoon het in die hotel. Hierdie een sê dit, maar daar was deurgaans ekstra personnel van hulle wat daar gebly het.

Daar word hier gepraat van "five officers". --- Ja, dit hang af watter – dit was verskillende, ek ken nou nie die name van die opleidingsgroepe nie, daar is verskillende name vir die opleidingsgroepe en hulle offisiere het al ons suites opgevat. Dit was 'n verpligting van hulle of 'n vereiste van hulle dat hulle in suites bly."

[26] It is therefore clear that only 38 students were going to stay for two years. The evidence of Fourie that the students would have occupied 70% of the hotel for the full duration of

the contract (two years) was clearly exposed as being less than candid.

26.1 I will accept that the appellant incurred costs in relation to improvements and repairs made to the structure in order to secure the contract. Those costs were incurred in 1999 and 2000. The appellant could claim from the respondent for the repairs done during these periods. The improvements to the hotel were not done to the appellants' prejudice. The students as well as ordinary guests could still use the hotel after the renovations were done. There is no indication that the renovations rendered the hotel unsuitable for guests other than the students.

26.2 It was pointed out that the telephone bills for 2002 was R414 000.00 whereas during 2001 before the students arrived it was R465 000.00. The linen expenses in 2001 was R172 718.00 and in 2002 when the students were staying there it was R162 914.00. During 2001 – before the students moved in the appellant had 58 cleaning posts and during 2002 when the students were there the appellant had 47 cleaning posts. The wages for 2001 was R2.3 million and for 2002 it was

R2.2 million and for 2002 it was R2.2 million. The turnover for 2001 was R9.4 million whereas in 2002 it was R8.06 million. It is significant that the appellant did not retrench or lay off any employees because of the loss of this contract. These facts and figures clearly show that the Naschem contract was never part of the appellants profit / income making structure.

[27] This hotel functioned quite well with or without the Naschem contract. There is no indication that the appellant's profit making structure was crippled or destroyed by the cancellation of the agreement. The hotel could and did continue as a profit earning asset. The agreement between Naschem and the appellant was not an essential part of the profit making machine or structure of the appellant. It was incidental to the working of the profit making machine. The agreement was a normal contract incidental to the normal course of the appellant's business. The appellant's business, as a provider of accommodation, was to secure as many contracts for accommodation and catering as the hotel could cater for and their profits were gained by giving accommodation and catering at a fee. The cancellation of an individual booking or a group booking is a shock that hotels

are fashioned to absorb as one of the normal incidents to look for in the hotel business.

[28] The sum of money received by the appellant was not in a material sense received as compensation for not being allowed to make profit by not hiring out rooms at the hotel, i.e. it was not received in respect of the termination or sterilization of any part of the appellants' business. It was also not received in respect of a capital asset. The capital asset (the hotel) could forthwith be harnessed to produce profit by hiring out rooms.

[29] It is clear to me that the appellant was compensated for the loss of profit that it would have made had the students not moved out. It was paid to help with its cash flow problems. It is therefore not surprising that the appellant used ±R500 000.00 of the money to service a loan and another R500 000.00 to pay its current liabilities. If the repairs that had to be done to the hotel were so extensive one would have expected the appellant to use a substantial amount of the money in order to do those repairs. The appellant did not even quantify, in monetary terms, the extent of the repairs. The figure given, was clearly a thumb suck. In any event if

the money was paid in order for the appellant – as Fourie contents – to effect repairs then in my view that compensation would still be of a revenue nature. Expenditure to restore or maintain an asset to its normal function is not capital. It is revenue and is deductable as a revenue expense. An accrual or compensation to effect the necessary repairs would therefore also be of a revenue nature.[14] In my view the appellant has not succeeded in proving on a balance of probabilities that the compensation was of a capital nature.

[30] A true reflection of what actually happened here is to be gleaned from Ms Gerber's evidence as quoted in paragraph 13 of this judgment. It is clear from her evidence that the compensation was in truth for costs incidental to the

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14. See section 11 (d) of the Act which reads as follows:
General deductions allowed in determination of taxable income.
For the purpose of determining the taxable income derived by any person from carrying on any trade within the Republic, there shall be allowed as deductions from the income of such person so derived –
(a) ...
(b) ...
(c) ...
(d) expenditure actually incurred during the year of assessment on repairs of property occupied for the purpose of trade or in respect of which income is receivable, including any expenditure so incurred on the treatment against attack by beetles of any timber forming part of such property and sums extended for the repairs of machinery, implements, utensils and other articles employed by the taxpayer for the purposes of his trade.
See also Fleming v Kommissaris Van Binnelanse Inkomste 1995 (1) SA 574 (AD).

performance of the income – producing operations of the appellant.[15]

In **London & Thames Haven Oil Wharves Ltd v Attwooll** (1966) 43 TC 491 the company's jetty was damaged by an oil tanker. The company received payment from the tanker owner and from its own insurers, which exceeded the cost of repairing the jetty. The insurance was for physical damages only but it was agreed with the insurers that the recovery from the tanker owner should be taken to include a sum of the loss of use of the jetty whilst undergoing repair. Lord Diplock found that the compensation for the loss of use of the jetty was to make up a hole in the profits and was taxable. He stated it as follows at page 515.

> "I start by formulating what I believe to be the relevant rule. Where, pursuant to a legal right, a trader receives from another person compensation for the trader's failure to receive a sum of

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15. See ITC 1267: 39 SATC 146 at 148 wherein the following quote from New State Areas Ltd v CIR 14 SATC 155 at 170 is quoted with approval: "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 ... then it is revenue expenditure, even if it is paid in lump sum."

> money which, if it had been received, would have been credited to the amount of profits (if any) arising in any year from the trade carried on by him at the time when the compensation so received, the compensation is to be treated for income tax purposes in the same way as that sum of money would have been treated if it had been received instead of compensation. The rule is applicable whatever the source of the legal right of the trader to recover the compensation."

This logical approach was confirmed by Lord Hoffman in **Deeny & Others v Gooda Walker Ltd & Others** (1996) 68 TC 458 at 509 G – 510 F. This approach is also in conformity with what was said by Pollak AJ in ITC 723 : 17 SATC 496 that:

> "It seems clear that an amount received such as the present, by way of damages or by way of settlement of an action for damages, is income and not capital, if the transaction out of which the claim for damages arose is a transaction which, had it been completed, would have resulted in an income and not in a capital gain or loss as the case might be."

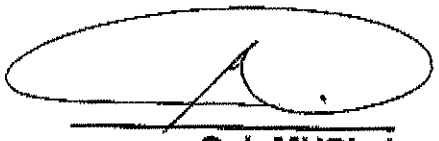
[31] If the transaction in casu had been completed the result would have been an income gain. It would have been

taxable. In my view the compensation was a revenue and not a capital receipt. The appeal ought to fail.

[32] Although Mr Stevens is in the full time employ of the respondent he requested us to make a cost order in the respondent's favour because the respondent incurred expenses in relation to this appeal. The respondent is successful and there is no reason why the costs should not follow the result.

[33] **Consequently I make the following order:**

The appeal is dismissed with costs.



C.J. MUSI, J

I concur.

G. A. HATTINGH, J

I concur.

C.H.G VAN DER MERWE, J

On behalf of the appellant: Adv. C. Van Breda
Instructed by:
Israel Sackstein Matsepe inc.
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On behalf of the respondent: Adv. G. Stevens
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