THE SUPREME COURT OF APPEAL OF SOUTH AFRICA
JUDGMENT

Reportable
Case No: 157/2018

In the matter between:

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE **APPELLANT**

and

BIG G RESTUARANTS (PTY) LTD **RESPONDENT**

Neutral citation: *CSARS v Big G Restaurants (Pty) Ltd* (157/18) [2018] ZASCA 179 (3 December 2018)

Coram: Ponnan, Mbha, Mathopo and Schippers JJA and Rogers AJA

Heard: 19 November 2018

Delivered: 3 December 2018

Summary: Income tax – s 24C of the Income Tax Act 58 of 1962 – whether income of taxpayer in years of assessment received or accrued in terms of franchise agreement – used to finance future expenditure incurred by taxpayer in the performance of obligations under that agreement – income and obligations must originate from the same contract.

ORDER

On appeal from: Tax Court of South Africa, held in Cape Town (Cloete J sitting as court of appeal in terms of s 107(1) of the Tax Administration Act 28 of 2011):

1 The appeal is upheld with costs, including the costs of two counsel.

2 The order of the court a quo is set aside and replaced with the following:

'The appeal is dismissed.'

JUDGMENT

Schippers JA (Ponnan, Mbha and Mathopo JJA and Rogers AJ concurring):

[1] Section 24C of the Income Tax Act 58 of 1962 (the Act) provides for an allowance in respect of future expenditure against income received by or accruing to a taxpayer which will be utilised in whole or in part to finance that expenditure. The main issue in this appeal, with leave of the court a quo, is whether the income which the taxpayer received from operating a franchise business, included any amount received or accrued in terms of a franchise agreement, as envisaged in s 24C of the Act.

[2] The matter came before the court a quo as a special case in terms of rule 42 of the tax court's rules read with rule 33 of the Uniform Rules of Court. The agreed facts, in summary, were these. The respondent, Big G Restaurants (Pty) Ltd (the taxpayer), is a franchisee that operates restaurants in terms of various written franchise agreements with the franchisor, Spur Group (Pty) Ltd. The

terms of the franchise agreements are virtually identical. A copy of one of those agreements annexed to the special case (the franchise agreement) was considered to reflect the terms of all the agreements. In terms of clause Q.1.1 of the franchise agreement the taxpayer gave an undertaking in favour of the franchisor that during the currency of the agreement, the main object and sole business carried on by the taxpayer would be the operation of Spur Steak Ranch Restaurants and restaurants specialising in pizza and pasta, under the style of Panarottis.

[3] The taxpayer was obliged, in terms of clause J.2 of the franchise agreement, to pay the franchisor a monthly franchise and service fee of 5% of the gross sales, less VAT attributable to the gross sales, for each of the restaurants it operated. The minimum monthly franchise fee payable during the currency of the agreement was R25 000, which escalated by the Consumer Price Index (CPIX), compounded annually.

[4] In terms of clause L.1.4 of the franchise agreement, the taxpayer was required to upgrade and/or refurbish its restaurants at reasonable intervals as determined by the franchisor.

[5] In respect of its 2011 to 2014 years of assessment, the taxpayer claimed certain amounts in terms of s 24C of the Act in relation to future expenditure to be incurred by virtue of the obligation imposed by the franchise agreements to upgrade and refurbish its restaurants.

[6] In the special case the court a quo was asked to decide two questions of law. The first was whether the income received by the taxpayer from operating the franchise businesses, were amounts received or accrued in terms of the franchise agreement as envisaged in s 24C of the Act. The second was whether

the expenditure required to refurbish or upgrade restaurants was incurred 'in the performance of the taxpayer's obligations under such contract', as contemplated in s 24C.

[7] The court a quo found for the taxpayer. It held that the taxpayer's income was income earned for purposes of s 24C under the same contract as that under which the taxpayer's future expenditure was to be incurred. Consequently, it made an order setting aside the additional assessments raised by the appellant, the Commissioner for the South African Revenue Service (the Commissioner), for the taxpayer's 2011 to 2014 years of assessment. The parties were ordered to pay their own costs.

[8] At the relevant time s 24C read:

'(1) For the purposes of this section, 'future expenditure' in relation to any year of assessment means an amount of expenditure which the Commissioner is satisfied will be incurred after the end of such year–

(a) in such manner that such amount will be allowed as a deduction from income in a subsequent year of assessment; or

(b) in respect of the acquisition of any asset in respect of which any deduction will be admissible under the provisions of this Act.

(2) If the income of any taxpayer in any year of assessment includes or consists of an amount *received by or accrued to him in terms of any contract* and the Commissioner is satisfied that such amount will be *utilised in whole or in part to finance future expenditure* which will be *incurred by the taxpayer in the performance of his obligations under such contract*, there shall be deducted in the determination of the taxpayer's taxable income for such year such allowance (not exceeding the said amount) as the Commissioner may determine, in respect of so much of such future expenditure as in his opinion relates to the said amount.

(3) The amount of any allowance deducted under subsection (2) in any year of assessment shall be deemed to be income received by or accrued to the taxpayer in the following year of assessment.'[1]

[1] Emphasis added.

[9] Mr Lüderitz SC for the Commissioner alluded to various provisions of the franchise agreement and submitted that on any interpretation of those provisions, the taxpayer did not earn income from the franchise agreement. It merely enabled the taxpayer to earn income. Instead, the taxpayer received income in terms of the *ad hoc* contracts it concluded with patrons when it sold meals to them (the patron contract).

[10] Mr Emslie SC for the taxpayer conceded that the taxpayer would not earn any income if it did not provide meals to patrons, but contended that it was obliged to do so in terms of the franchise agreement, which was not only the source of the taxpayer's income, but also spelt out how it was obliged to operate its restaurants. Relying upon *Oosthuizen*,[2] he submitted that the words 'in terms of' (in the signed Afrikaans text, 'ingevolge'), hereafter 'the phrase', in s 24C(2) should be given a wide meaning, namely that the taxpayer's income was earned 'pursuant to' or 'in accordance with' the franchise agreement.

[11] The phrase has an 'ordinary' (narrow) or 'wide' meaning, as appears from the judgment of this court in *Slims*.[3] The case concerned the meaning of the word 'under' (in the signed Afrikaans text, 'kragtens') in s 37(5) of the Insolvency Act 24 of 1936. After emphasising that the meaning of a word depends upon the subject matter and the context in which it appears, Botha JA said:

'In my view the word "kragtens" is clearly capable of bearing different shades of meaning. Used as a link a word, connecting two concepts, it is capable of connoting varying degrees of closeness between the one concept and the other. In the narrow sense, at the one end of the spectrum, it may be used to denote a direct and immediate connection between the two concepts linked by it ("uit krag van", "luidens"). In a wide sense, at the other end of the

[2] *Oosthuizen & another v Standard Credit Corporation Ltd* 1993 (3) SA 891 (A) at 900J-901B.
[3] *Slims (Pty) Ltd & another v Morris NO* 1988 (1) SA 715 (A) at 744G-H.

spectrum, it may connote no more than a loose and indirect relationship between the two concepts ("ten gevolge van", "uit hoofde van") . . . . In this sense the word could, I consider, be rendered appropriately as "voortspruitend uit". . . . Similarly, the English word "under" has different shades of meaning. Some of the meanings ascribed to it in the cases are: 'in terms of', "in accordance with", "in compliance with", "in pursuance of", "by virtue of", and "pursuant to" . . . In its wide meaning the word is certainly not confined, in my view, to the designation of a direct or exclusive connection between the two matters which it serves to link to each other.' [4]

[12] Botha JA held that in the particular context the wide meaning should be preferred.[5] Van Heerden JA and Nicholas AJA concurred in Botha JA's judgment.[6] Corbett JA, in whose judgment Nestadt JA concurred, concluded that the words 'right under the lease' meant 'a right arising from, created by or having its origin in, the lease',[7] ie the narrow meaning.

[13] In *Oosthuizen*[8] the question was whether a particular lease agreement was a credit agreement 'in terms of which [ingevolge waarvan] a person purchases or hires goods for the sole purpose of selling or leasing them. . . .' Nicholas AJA, in whose judgment Smalberger JA concurred, answered this question in the affirmative. Kumleben JA (with whom Botha JA and Kriegler AJA concurred) took the opposite view. The majority held that 'in terms of' ('ingevolge') in the context under consideration meant 'by virtue of' or 'in consequence of', ie the wide meaning.

[14] The next stage of the enquiry is to consider the sense in which the phrase is used in s 24C(2). The section has two basic requirements. First, there must be income received or accrued in terms of a contract. Second, the Commissioner

[4] *Slims* fn 4 at 733B-G.
[5] *Slims* fn 4 at 732D-733H.
[6] *Slims* fn 4 at 729C-D.
[7] *Slims* fn 4 at 743G-H.
[8] Footnote 2.

must be satisfied that such amount, ie the income received from the contract, will be used wholly or partially to finance future expenditure that a taxpayer will incur in performing its obligations under that same contract. There is thus a direct and immediate connection between these two requirements.[9] The section does not allow for different income-earning and obligation-imposing contracts.

[15] The fact that the income and obligations must originate from the same contract points strongly to the conclusion that the special allowance in s 24C was intended to apply to cases where income earned in terms of (or 'by') a contract is received before expenditure will be incurred to perform obligations under that same contract. Mr Emslie SC correctly conceded that the expression 'obligations under such contract' meant obligations created by the same contract. In other words, in relation to the obligations, the word 'under' ('ingevolge' in the Afrikaans text) has its ordinary or narrow meaning.

[16] The narrow meaning of the phrase, in my view, is supported by the context and the background to the provision. Section 24C constitutes an exception to the general prohibition contained in s 23*(e)* of the Act, which provides that no deduction shall in any case be made in respect of income carried to any reserve fund or capitalised in any way.[10] Section 24C was introduced by s 18(1) of the Income Tax Act 104 of 1980. According to the explanatory memorandum, the purpose of s 24C was to address situations where a contract, typically a construction contract, provides for an advance payment to enable the recipient to finance the performance of its obligations under the contract (eg to purchase materials). In the situation contemplated by the explanatory memorandum, the same contract creates the right to the income (the advance payment) and the obligation which has to be performed.

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[9] *Slims* fn 4 at 733B-C per Botha JA.
[10] D Clegg and R Stretch *Income Tax in South Africa* (2018) para 11.11.4.

[17] Applying the narrow meaning of the phrase, the question is whether the taxpayer receives income under the franchise agreement. The answer is clearly no. None of the rights accorded to the taxpayer under the franchise agreement are rights to income. This is hardly surprising, since a right to receive income by a franchisee is not an element of a franchise agreement. Features generally common to a franchise agreement are the granting of the right by the franchisor to conduct business in exchange for fees; the acquisition by the franchisee of the right to conduct a franchise business within the franchisor's network; and the right and obligation of the franchisee to use the franchisor's trademarks, know-how and business methods.[11]

[18] The taxpayer does not receive any advance payment or indeed any income from the franchise agreement, but earns income from each patron contract. Patrons have the right to receive food sold to them by the taxpayer and the corresponding obligation to pay for the food. The taxpayer's income is derived from payments received from patrons, directly as a result of food sold to them. If it does not sell food to patrons, the taxpayer will not receive any income.

[19] Mr Emslie SC however contended that the franchise agreement and the patron contract were inextricably linked, and that both these contracts required the taxpayer to serve meals to its patrons in order to earn income, out of which franchise fees were payable to the franchisor. He supported the court a quo's reasoning that given the 'contractual arrangement' in this case, the franchise agreement imposed on the taxpayer the obligation 'by necessary inference … to sell meals to its customers. Although the customers are not parties to that agreement, the proximate cause of those sales is that obligation'.

[11] *PE Pack 4100 CC v Sanders & others* [2013] 4 BLLR 348 (LAC) para 15.

[20] The argument is unsound. It is simply another way of putting the argument for the wide interpretation of the phrase. The argument acknowledges that the contract creating the right to the income is the patron contract but places reliance on the fact that the patron contract is able to be concluded because of the existence of the franchise agreement. The fact that a contract is useful or even necessary to enable a taxpayer to earn income does not mean that its income is earned 'in terms of' such contract. A taxpayer's income is not earned 'in terms of' the lease under which it occupies its commercial premises or 'in terms of' the overdraft agreement which provides it with the necessary working capital.

[21] A similar argument was essayed – and rejected – in ITC 1667.[12] In that case a taxpayer claimed a s 24C allowance, contending that although it received the income under a different contract than the one under which it was obliged to perform an obligation, the income transaction formed an integral part of a scheme that obliged it to incur future expenditure in carrying out its obligations. In dismissing the taxpayer's appeal, the court (Blignault J) correctly, in my view, held that s 24C(2) required that the taxpayer incur the expenditure in the performance of its obligations in terms of the same contract as the contract under which it received income. The legislature did not use the term 'scheme' or 'transaction': the operative concept was 'contract'.

[22] My conclusion on the first question of law is dispositive of the appeal. Consequently, it is unnecessary to decide the second question. It follows that the appeal must be upheld and the order of the court a quo set aside.

[23] I make the following order:

1 The appeal is upheld with costs, including the costs of two counsel.

[12] ITC 1667 (1999) 61 SATC 439 (C).

2 The order of the court a quo is set aside and replaced with the following: ‘The appeal is dismissed.’

A Schippers
Judge of Appeal

APPEARANCES

For Appellant:	K W Lüderitz SC (with him K D Magano) Instructed by: RW Attorneys, Pretoria Pieter Skein Attorneys, Bloemfontein
For Respondent:	T S Emslie SC (with him M Madison) Instructed by: Potgieter Joubert Inc, Cape Town Rosendorff Reitz Barry, Bloemfontein