REPORTABLE

IN THE TAX COURT

SOUTH GAUTENG (JOHANNESBURG)

CASE NO'S: 12323 & 12324

BEFORE

The Honourable Mr Justice N.P Willis President

E. Lai King Commercial Member

T. Fubu (formerly Kentane) Accountant Member

In the matter between:

A CO. LIMITED (Case 12323) Appellant no 1

B CO. LIMITED (Case 12324) Appellant no 2

and

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE Respondent

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JUDGMENT

WILLIS J:

[1] This judgment is concerned with two separate but related matters. The same counsel appeared in both matters and agreed that the court should proceed with the matter in which A Co. Limited is the appellant and in view of the substantial similarity of the issues between the matter and the one in which B Co. Limited is the appellant, the same order should follow in both matters. On the same day, viz. 1 March 2004, A Co. Limited sold its business as a going concern to X Ltd and B Co. Limited also sold its business as a going concern to the same purchaser, X Ltd. In effect, there was a consolidated or merger of businesses, with the same contract and the same principles, *mutatis mutandis*, applying in each case. These two cases are each concerned with the tax-deductibility of certain amounts consequent upon the sale of a business as a going concern. The court shall refer hereinafter to A Co. Limited as “the appellant”.

[2] The appellant’s 2004 income tax year of assessment ran from 1 July 2003 to
30 June 2004. The appellant sold its South African business as a going concern to X Ltd with effect from 1 March 2004. This sale was effected in terms of a written agreement (referred to by the parties and hereinafter as the “the Sale Agreement”), concluded on 1 March 2004. Clause 4 of the Sale Agreement reads as follows: “In consideration for the sale of the Business, The Purchaser will pay the purchase price…”The “Business” was defined in clause 2.2.3 of the Sale agreement as “the retail clothing business conducted by the Seller under the style of “A Co. Ltd”, which includes the Business Assets of the Seller, The Liabilities and the Contracts of the Effective Date”. The “Purchase Price” was defined in clause 2.2.21 of the Sale Agreement as “the amount equal to the sum of R800 000 000 (eight hundred million rand) and the rand amount of the Liabilities”. “Liabilities” was defined in clause 2.2.16 of the Sale Agreement to mean “all of the liabilities arising in connection with the Business, in respect of any period prior to the Effective Date, known o the Seller as at the Effective Date”.

[3] The appellant alleges that, upon the sale of its business, it made certain accounting provisions and that the relevant amount is the aggregate of the following accounting provisions made by it:

Provision	Rand
Bonus: long-term	6 394 111
Full repairing lease	900 000
Medical expenses	11 698 880
	(reduced to approx. 9 800 000)
Total	Approximately R17 million

As at 1 March 2004, the liabilities referred to in the above provisions had not come into existence and any obligation on the part of the appellant to discharge the liabilities relevant to the above provisions was conditional. To the extent that such liabilities were ever paid, they were paid by the purchaser, X Ltd, after 1 March 2004. Subject to the foregoing, the respondent agrees that these sums formed part of the liabilities referred to in the last three items of annexure “A” to the sale agreement and assumed by the purchaser as

part of the total liabilities in the sum of R329 440 402.

[4] In terms of clause 6.1 of the Sale Agreement the parties agreed the following:

"The Purchase Price shall be discharged as follows by the Purchase:

1. as consideration for the Inter Company Loans and Other Loans, the Purchaser will assume an equivalent amount of the Accounts Payable;

and

2. as consideration for the remaining Business Assets:

1. the Purchaser will assume the remainder of the Liabilities, and

2. the Purchaser will effect from (sic) the Effective Date owe Seller R800 000 000.00 (eight hundred million rand) as a loan and which will be reflected as a loan account in the books of the Seller."

[5] In terms of clause 5.1 of the Sale Agreement, the parties agreed that "the Purchase Price (would be) allocated as follows to the Business Assets":

1. Immovable Property, the net book value as reflected in the Effective Date Management Accounts".
2. Plant, machinery, equipment, vehicles, trade debtors, inter company loans, other loans and inventory, the net book value as reflected in the Effective Date Management Accounts
3. Trade Debtors, "the net book value as reflected in the Effective Date Management Accounts".
4. Inter Company Loans, "the net book value as reflected in the Effective Date Management Accounts".

5. Other loans, “the net book value as reflected in the Effective Date Management Accounts”.
6. Inventory, “the net book value as reflected in the Effective Date Management Accounts”.
7. Cash and cash equivalents, “the face value as reflected in the Effective Date Management Accounts”.
8. Trademarks, “the market value determined by the Seller as at the Effective Date”.
9. Goodwill, “the balance”.

[6] The “Effective Date Management Accounts” were defined in clause 2.2.8 of the Sale Agreement to mean:

> “the management accounts reflect the financial affairs of the Business on the day immediately preceding the Effective Date, which shall be attached as Annexure “A” hereto as soon as possible after the Effective Date.”

[7] Annexure “A” to the Sale Agreement is headed “Analysis of purchase price” and allocates an amount of R800 million. The amount R800 million is the difference between the aggregate of the positive amounts reflected in Annexure “A” (R1 111 692 717) and aggregated of the negative amounts reflected in Annexure “A” (R311 692 717).

[8] In terms of clause 10 of the Sale Agreement, the parties agreed to “comply with their respective obligations in relations to the employees, as set out in Annexure “E”.

[9] In terms of paragraph 1.2 of Annexure “E”, the parties agreed that the purchaser, X Ltd, would be substituted in place of the seller in respect of all employment contracts in existence immediately before the effective date. Paragraph 2.1 of Annexure “E” reads as follows:

> "The Seller shall bear the costs of salaries, PAYE income tax, employer UIF, pension and medical aid contributions, leave pay and other benefits in respect of the Employees accrued in respect of any period up to and including the Effective Date."

[10] Paragraph 2.2 of Annexure "E" reads as follows:

> "The Purchaser shall bear the costs of salary, PAYE income tax, employer UIF, pension and medical aid contributions and other benefits in respect of the Employees in respect of the period after the Effective Date."

[11] Paragraph 2.3 of Annexure "E" reads as follows:

> "For the purposes of section 197(7)(4) of the LRA[1], the Parties will agree on or before the Effective Date, the valuation up (sic) and including the Effective Date of:

1. accrued salary, PAYE income tax, employer UIF, pension and medical aid contributions in respect of Employees;
2. leave pay accrued to the Employees;
3. severance pay that would have been payable to the Employees in the event of a dismissal by reason of the Seller's operational requirements; and
4. any other payments that have accrued to Employees but have not been paid…."

[12] The appellant has not been able to locate any valuation as contemplated in paragraph 2.3 of Annexure "E".

[13] Paragraph 2.5 of Annexure "E" reads as follows:

> "On the Effective Date the Seller shall pay to the Purchaser the sum of the calculation referred to in 2.2 above in respect of accrued salary, leave pay, PAYE income tax, employer UIF, pension and medical aid contributions in respect of the Employees in respect of the period up to and including the Effective Date, which amounts have not otherwise been paid in respect of the Employees.."

[14] No payment was made by the appellant in cash in respect of the liability in paragraph 2.2 of Annexure "E" but X Ltd, as the purchaser, assumed all liabilities in respect of employees.

[15] The appellant has conceded that there are no documents other than the Sale Agreement evidencing the payment of the alleged "expenditure" at issue and this was confirmed by Mr.Z who gave evidence for the appellant in the hearing before the court.

[16] The Purchaser, X Ltd, duly discharged its contractual obligations in regard to the payment of the purchase price and took transfer of the appellant's business.

[17] The respondent has issued an additional assessment in respect of the appellant's 2004 year of assessment , in which the respondent has disallowed an amount of R23 017 959 which was claimed by the appellant as a deduction. The respondent delivered its Statement of Grounds of Assessment in terms of Rule 10 of the Rules issued in terms of section 107A of the Act. The appellant delivered its Statement of Grounds of Appeal in terms of Rule 11 contending that it was entitled to the deduction of the amount R23 017 959 in terms of section 11(a), read with section 23(g) of the Act. The respondent amended its Statement of Grounds of Assessment and the appellant amended its Statement of Grounds of Appeal.

[18] The appellant has abandoned the appeal in respect of an amount of R4 024 968. The appellant persists with its claim that it should be allowed to deduct from its taxable income amounts of three underlying contingent liabilities being R9 800 667 in respect of post-retirement medical aid liability (the appellant concedes that the initially claimed deduction of R11 698 880 should be reduced to this figure), R6 394 111 in respect of long-term bonuses and R900 000 in respect of "full repairing leases". The total amount claimed amounts to approximately R17 million which shall herein after be referred as to "the relevant amount".

[19] The respondent disallowed the deductions claimed by the appellant on the following grounds:

(i) they do not constitute "expenditure";

(ii) they do not constitute expenditure actually incurred;

iii. they do not constitute expenditure incurred in the production of income;

iv. if they were expenditures, they were expenditures of a capital nature;

v. if they were expenditures, they were not incurred for the purpose of trade;

vi. they were, in any event prohibited from deduction in terms of section 23(e) of the Income Tax Act, No 58 of 1962, as amend ("the Act");

vii. they were, in any event prohibited from deduction in terms of section 23(f) of the Act;

iii. they were, furthermore, in any event prohibited from deduction in terms of section 23(g) of the Act.

Mr *Rogers* conceded, fairly and correctly, that if the respondent was successful in respect of any one of these grounds, his assessment would have to be confirmed. These grounds will be considered later *seriatim*.

[20] The relevant portion of section 11 of the Act reads as follows:

> For the purpose of determining the taxable income derived by any person from carrying on any trade, there shall be allowed as deduction from the income of such person so derived-

1. expenditure and losses actually incurred in the production of the income, provided such expenditure and losses are not of capital nature...

In terms of subsections (e), (f) and (g) of section 23 of the Act deduction may not be made in respect of the following respectively:

(e) income carried to any reserved fund or capitalized in any way;

> (f) any expenses incurred in respect of any amounts received or accrued which do not constitute income as defined in section one;
>
> (g) any monies claimed as a deduction from income derived from trade, to the extent to which such monies were not laid out or expended for the purposes of trade.

[21] Much of the appellant's case rests on the construction which it wished to place on events that clause 2.2.21 provides that the purchase was "the amount equal to the sum of R800 million" <u>and</u> "the rand amount of the liabilities". In other words, the purchase price was R1 111 692 717 (R800 million plus R311 692 717 (the amount of the liabilities)). Accordingly, so the argument went, the appellant forewent the portion of purchase price representing the liabilities in consideration for the purchaser, X Ltd, assuming those liabilities. Therefore, so it was submitted on behalf of the appellant, this portion of the purchase price represents "expenditure...incurred" within the meaning of section 11(a) of the Act. Furthermore, the appellant submitted, expenditure incurred by a taxpayer to rid itself of anticipated or contingent revenue expenses is generally itself of a revenue nature, and this analysis holds true in the present case as well. It should immediately be observed that the audited accounts of the appellant reflect the purchase price or

"consideration" simply as R800 million. The appellant attempted to surmount this difficulty by arguing that there had been an immediate and instantaneous set-off of the sum of R311 692 717, representing liabilities against the sum of R1 111 692 717, which happened in such a rapid twinkling of the eye as to explain the accounts reflection a purchase price of R800 million. Quite some time during the hearing of the matter was spent analyzing and debating the mechanics, arithmetic and law of set-off. It is necessary to linger on the issue. The court shall provisionally accept, in favour of the appellant, that the purchase price was indeed the sum R1 111 692 717 and that against this sum was set off the amount of R311 692 717, which included the contingent liabilities, constituting the relevant amount. In other words, the court will finally decide whether or not there was indeed a set-off only in the event that it becomes necessary to do so.

[22] The court accepts that if the appellant had retained its business and continued to trade, the contingent liabilities would have been deductible in the appellant's hands as and when they became unconditional. The court also accepts that the salary and other benefits which a taxpayer pays to employees employed in the taxpayer's business are obviously ordinarily incurred in the production of income and are of a revenue nature. The court accepts Mr *Rogers*' submission that, ordinarily, benefits such as post-retirement medical aid subsidies and long-term bonuses are designed to attract and retain high-quality staff and to provide incentives to them to render good service, all of the benefits of the business. Similarly, the court accepts that rent and related property expenditure (e.g maintenance, repair and restoration) incurred by a taxpayer for the use of the premises from which the taxpayer trades are ordinarily revenue expenses incurred in the production of income.[2]

[23] The appellant accepted that it would only have been entitled to these deductions as and when they became unconditional. The appellant also accepts that if the appellant had retained its business, it could not have claimed, as deductions, provisions raised in its accounts in respect of the anticipated or conditional liabilities. The appellant contends, however, that it has not sought to deduct the contingent liabilities it had to employees and landlords as at 1 March 2004. The appellant accepts that these liabilities were conditional,

and that it is trite that a liability does not constitute “incurred” expenditure until it becomes unconditional.[3]

[24] The appellant contends, however, that the conclusion of the sale agreement with X Ltd gave rise to incurred expenditure towards X Ltd in an amount equal to the contingent liabilities in issue. It is this expenditure which the appellant seeks to deduct. Accordingly, Mr *Rogers* submitted, the expenditure was actually incurred within the meaning of section 11(a) of the Act. There had, so the argument went, been a diminution of the appellant’s patrimony the same as a loss and, accordingly, relying on *Joffe & Co v CIR*[4] and *Port Elizabeth Electric Tramway Co v CIR*[5], the relevant amount was deductible.

[25] The argument went further: if deductible “losses” can exist independently of a legal liability, there is no reason to suppose that “expenditure” must necessarily have its source in a legal liability owed by the taxpayer to a third party. Mr *Rogers* submitted that the phrase “expenditure and losses actually incurred” is a deliberately wide one which is intended to cover all actual, quantifiable diminutions or prejudicial effects suffered by the taxpayer’s patrimony and that the diminution of the taxpayer’s patrimony will very often arise from legal liabilities undertaken by the trader. In that situation, the diminution or prejudicial effect does not take place until the liability is unconditional, and that is when expenditure of that kind is “incurred”. Mr *Rogers* submitted that one should deduce from the case holding that the liability must be unconditional that there can only be expenditure where there is a liability owed to a third party. Those cases, reasoned Mr *Rogers,* must be understood in the context of the facts which they were dealing, i.e. expenditure (a negative patrimonial effect) in the form of an alleged legal liability. Mr *Rogers* went on to argue that “expenditure and losses” is an economic or commercial concept, rather than one related to strict law or obligation. The economic consequences of a transaction or event should, in Mr *Rogers’* contention, thus be examined to see whether it has resulted in an actual diminution or prejudicial effect of the taxpayer’s patrimony. Even if one accepts that it is the economic consequences of a transaction which must be examined rather than “strict law or obligation”, the economic consequences of the transaction or transactions between the appellant and X

Ltd, as purchaser, were that X Ltd took on the risk, and the appellant was relieved of the risk, that the contingent liabilities in question would materialise. Rather than there being a diminution of the appellant's patrimony, there was an increase. After all, in the circumstances, who would be quibble at the net acquisition, risk-free, of R800 million – assuming, of course, that the purchaser pays the loan?

[26]Mr *Rogers* attempted to straddle this difficulty by submitting that the distinction posited by the question does not lead to the assumed conclusion: although a business may be said to comprise assets and liabilities, one cannot, in law, sell a liability – only the asset can be the subject of a sale; a liability can only be delegated or assigned. Mr *Rogers* reasoned that when an asset is sold, the seller becomes entitled to receive a price but that when a liability is delegated, the assignor typically would have (rather than receive) value to the assignee: accordingly, when a person sells a business, what that person actually sells are the assets (inclusive of goodwill). On the other hand, so Mr *Rogers* submitted, when liabilities are assigned as part of the contract, this is a delegation and will typically (as in this case) be reflected in an adjustment to the price of the assets. Mr *Rogers* accepted that, commercially, it may be convenient to view the net value of the business as an asset, but then contended that is legally inaccurate and untenable. In this regard he relied on the following, said by Nugent J, as he then was, in *Kerbyn 178 (Pty) Ltd v Van den Heever & Others NNO*[6]

> Further, I know of no authority which recognises a 'business' as a discrete form of property separate from its component parts, and in principle it would seem to me it is not. One might ask, for example, how the rights and obligations of debtors and creditors, or the ownership of corporeal property, would be dealt with by any such legal concept. In my view, what is often referred to as a 'business as a going concern' is no more than a collection of real and personal property which has no separate legal existence, and the term is merely a convenient description which is given to that collection.

It may be observed, with respect, that Nugent J was, of course, correct. Of course, one may accept Mr *Rogers'* argument that the fact that, commercially, the business was defined as comprising both assets and

liabilities, does not mean that the assets on the one hand and the liabilities on the other lost their respective identities. The difficulty which the appellant faces is that Mr *Rogers* submitted in one breath that it is "the economic consequences of a transaction or event which should be examined" to determine whether there has been a diminution of the taxpayer's patrimony and that one should not take a strictly legalistic view of the matter but in the next breath, he submits that one must apply the legality that when a business is transferred this entails the sale of assets and the assignment of obligations. Colloquially, this is known as wanting to "have one's cake and eat it at the same time". The truth is that if one takes a holistic, economic and commercial view of the transaction or transactions between the appellant and the purchaser, there was no diminution of the appellant's patrimony: the contrary is true; and, if one looks strictly at the assignment of obligations, including the contingent liabilities of the appellant to the purchaser, as if this was a "stand alone" transaction, the appellant suffered no loss: once again, on the contrary, and, as has been observed previously, X Ltd, the purchaser, took on the risk, and the appellant was relieved of the risk, that the contingent liabilities in question would materialise. As for the question of whether the contingent liabilities, included in the "payment" of R311 692 717, constituted "expenditure...actually incurred" as provided for in section 11(a) of the Act, this will be dealt with in paragraphs [29] to [31] below.

[27] Mr *Rogers* submitted that, in general terms, "there is relatively little South African authority directly in point and thus it is useful to review the more extensive jurisprudence of England and Australia". We were referred to *Smith v Incorporated Council of Law reporting for England and Wales;*[7] *Hancock v General reversionary & Investment Co Ltd;*[8] *Rowntree & Co Ltd v Curtis;*[9] *British Insulated & Helsbury Cables Ltd v Atherton;*[10] *Anglo-Persian Oil Co Ltd v Dale;*[11] *Heather v P-E Consulting Group Ltd;*[12] *Vodafone Cellular Ltd v Shaw (HM's Inspector of Taxes);*[13] *Spotlight Stores (Pty) Ltd v CoT;*[14] *Pridecraft (Pty) Ltd v CoT; CoT Spotlight Stores (Pty) Ltd* (the two cases being heard together)[15] and the South African case of *SIR v John Cullinan Construction Co (Pty) Ltd.*[16] These cases are interesting but, for reasons which, we trust, will become clear a little further on, quite unhelpful for the appellant. They all dealt with "limp sum" deductions. Whether payments are for a "lump sum" or even, as was artfully argued, "compressed expenditure" does not alter or even answer the questions that have necessarily been posed in this case such

as whether or not the relevant amount constitutes "expenditure"; whether it was actually incurred; whether it was incurred in the production of income; whether it was of a capital nature; whether it incurred for the purposes of trade; and whether or not it was capitalised in any way. The court accepts, however, the thrust of Mr *Rogers'* argument that while "lump sum" payments may generally, at first blush, have a "forbidden" character when it comes to tax-deductibility, this is not necessarily the case. It will, no doubt, be the appellant's lament that this well-prepared argument does not assist it in this case. It should be added that, at no stage was the court, in the slightest way beguiled, led astray, disturbed or perturbed by the "lump sum" character of the relevant amount.

[28] The court will now consider *seriatim*, the points pertinently and directly posed by the respondent's ground of assessment and the appellant's grounds of appeal. As noted earlier, an answer of any one of these grounds which favours the respondent, decides the entire case in his favour. Nevertheless, in case the court is wrong in respect of any one ground, it shall consider them all.

[29] The question of whether the claimed deductions constitute "expenditure". The deductions can only constitute "expenditure" if one accepts Mr *Rogers'* construction of events that the appellant "paid" X Ltd R311 692 717 in order to be relieved of its (the appellant's) liabilities. The underlying "expenditure" relating to the relevant amount was part of the liabilities reflected in the accounting provisions of the appellant. As has been mentioned above, the accounting records of the appellant do not support this construction but even if one accepts this construction of events in appellant's favour, it faces other difficulties in respect of its claimed deductions. It is common cause that the liabilities constituting the relevant amount had not yet come into existence on 1 March 2004 (the day on which they were transferred to the purchaser, X Ltd) and that they were conditional. It is clear that that until such liabilities become unconditional they do not constitute "incurred" expenditure.[17] In any event, the appellant faces other difficulties which are dealt with in paragraphs [30] to [35] below. It therefore seems futile to dwell on this aspect any further.

[30] The question to whether the "expenditure" constitute expenditure actually incurred. This issue is closely related to the previous one. The expenditure on the relevant amount could only have been incurred if one accepts construction of events that the appellant "paid" X Ltd R311 692 717 in order to be relieved of its (the appellant's) liabilities. It is quite clear that as at 1 March 2004 the relevant amount consisted of merely conditional liabilities in respect of which there was no obligation to effect payment and, therefore no expenditure relating thereto could possibly have been incurred. Again by reason of the other difficulties which the appellant faces, not least of which that the delegation of liabilities by the appellant to X Ltd, represents a decrease in patrimony, there seems little point in dwelling on this issue. As stated in paragraph [25], the court is of the view that there was an increase in patrimony.

[31] The question of whether the expenditure constitutes expenditure incurred in the production of income. This question is closely related to the previous two: it only arises if one accepts that the appellant "paid" X Ltd R311 692 717 in order to be relieved of its (appellant's) liabilities, in other words to generate income not of R800 million but of some R1.1 billion. Nevertheless, if one reads the definition of "income" together with that of "gross income" in the Act, it is clear that "income" excludes "receipts or accruals of capital nature". In any event, Mr *Rogers* informed the court that the disposal by A Co. Ltd to X Ltd was done in terms of section 45 of the Act No. 58 of 1962. Section 45 provides for intra-group transactions to be carried out on a completely tax neutral basis. In reply to questions by the commercial member of the court, Mr *Rogers* submitted that the "expenditure incurred" was not in the production of "income" from the disposal but in the production of income previously earned by the appellant during the period that it traded – prior to selling the business. Accordingly, so his argument went, the "notional agreement expenditure" comprising the amount "paid" to X Ltd of R311 692 717 in order for the latter to assume the appellant's contingent liabilities was incurred on payment and therefore had converted uncontingent expenditure, i.e. the "underlying expenditure" which he concedes was contingent expenditure, into uncontingent, deductible expenditure. The insurmountable difficulty with this argument for the appellant is that it is clear that the "notional agreement expenditure" did not produce "income" arising from the sale of the business. In fact the "payment", if there

ever was a payment, was to induce X Ltd to assume the liabilities. Has the appellant not sold its business and settled its liabilities in the normal course of trading, it would be arguable that the expenditure would be incurred in the production of income. The "notional agreement" was however, clearly "incurred" in order to induce X Ltd to assume the liabilities, rather that incurred in the production of income prior to the sale of the business.

[32] The question of whether, even if the relevant amounts survive the previous three enquiries, the expenditures, such as they were, were expenditures of a capital nature. The self-evident consequence of the transaction (or, on the appellant's version of events, series of transaction) between the appellant and X Ltd was that the appellant ceased trading. The usual tests to determine the nature of expenditure i.e. capital or revenue is to establish whether the expenditure is more closely connected with the income earning operations i.e. revenue expenditure or income earning structure i.e. capital expenditure. As the sale of the business would, by its very nature, cause a cessation of trading, the appellant has been unable successfully to argue that the expenditure incurred in relation to the sale would be more closely connected to its income earning operations.

[33] The question of whether the relevant amount was not incurred for the purpose of trade. It has been observed that section 23 (g) of the Act disallows deductions for moneys which were not laid out or expended for the purpose of trade. This means, *inter alia,* that the expenditure must have been incurred for the purpose of or in connection with its profit making activities.[18] By reason of the definitions of "income" and "gross income" in section 1 of the Act, to which reference has been made in paragraph [31] above, this must necessarily mean profit derived from the income generating activities of the taxpayer. The transaction or transactions in question were undertaken with a view to enabling the appellant to sell its business to X Ltd as a going concern and, in particular, for the purpose of bringing an end to the appellant's trading activities. There can be no question that the appellant did not pay the relevant amount prior to the happening of the event which brought about the cessation of its trading activities. The expenditure, if such it was, was not laid

out or expended for the purposes of appellant's trade. This question must also be answered in favour of the respondent. The court wishes to record that we were referred by counsel for both sides to the judgment of Labe J in *ITC* 1627 (1997), 60 SATC 26 wherein he supported the view that trading only ceases when all debts of the business have been settled. We are aware that Labe J's view has not escaped criticism and that a different view has been taken[19] but, in the light of the approach which the court has taken in this matter it is unnecessary to decide which is the better view.

[34] <u>The question of whether the expenditure had been capitalised in any way, contrary to the provisions of section 23 (e) of the Act.</u> Section 23(e) provides that no deduction shall be made in respect of "income carried to any reserve fund or capital in any way". Mr *Bhana* submitted that, precisely by reason of the fact that the relevant amount related to provisions for expenditure which had not, at time (1 March 2004), actually incurred been incurred, it has been capitalized. The court does not understand Mr Bhana's submissions as the instant matter does not involve the carrying of income to a reserve fund or capitalisation of income. The matter before the court is whether certain expenditure is deductible. Expenditure is clearly not income. No further discussion is therefore required on section 23(e).

[35] <u>The question of whether the relevant amount was, in any event, prohibited from deduction in terms of section 23(f) of the Act.</u> Section 23 (f) prohibits the deduction of any expenses incurred in respect of any amounts received or accrued which do not constitute income as defined in section one of the Act. R *Bhana* relied, in this regard, very much upon the following *dicta* of Corbett JA, as he then was, in *CIR v Nemojim (Pty) Ltd*:[20]

> Section 11(a) provides positively and in general terms in the case of a person deriving income from the carrying on of a trade within the Republic, what expenditure and losses shall be allowed as deductions from income so derived in order to determine his taxable income. The subsection limits the deductions to expenditure and losses incurred in the Republic in the production of the income, other than those of a capital

nature...[21]

Section 23 prescribes what deductions may not be made in the determination of taxable income. Subsection (f) and (g) represents, in general sense, the negative counterpart of s 11(a) and, in determining whether a particular amount is deductible, it is generally appropriate to consider whether or not such deduction is permitted by s 11(a) and whether or not is prohibited by s 23(f) and or (g)...[22]

The court will, therefore, treat 23(f) of the Acts as "in a general sense, the negative counterpart" of the "in the production of income" requirement of section 11(a). The court refers to its conclusion in paragraph [31] that the "notional agreement expenditure" was clearly "incurred" in order to induce X Ltd to assume the liabilities, rather than incurred in the production of income prior to the sale of the business.

[36] The question of whether the relevant amount was, in any event, prohibited from deduction in terms of section 23(g) of the Act.

This aspect has been dealt with in paragraph [33] above.

[37] It should be noted that the respondent originally relied upon only four grounds for disallowing the deduction of the relevant amount: (i) that it did not constitute expenditure actually incurred; (ii) it did not constitute expenditure in the production of income; (iii) it was expenditure of capital nature and (iv) it was incurred for the purpose of trade. This point is mentioned *ex abudanti cautela* purely to deal with the potential question of there being any significance in the respondent having initially disallowed the deduction on certain grounds and then "shifting the goalposts". Nothing turns on this point as at least one of these original four grounds of the respondent in disallowing the deduction of the relevant amount has been upheld. It follows that the conclusion of the court is that the deduction of the relevant amount was not allowed in terms of the Act.

[38] Counsel for both sides agreed that, regardless of the outcome, in neither case would be appropriate for the court to make any order as to costs.

[39] This judgment reflects the unanimous opinion of all the members of the court.

[40] The following is the order of the court in regard to both cases (12323 & 12324):

i. The appeal is dismissed;

ii. The assessment of the Commissioner for the South African Revenue Service under this appeal is confirmed.

DATED AT JOHANNESBURG THIS 14TH DAY OF MAY, 2009

N.P. WILLIS

JUDGE OF THE HIGH COURT

E. LAI KING

COMMERCIAL MEMBER

T. FUBU (Formerly KENTANE)

ACCOUNTANT MEMBER

Counsel for the Appellants: *O. Rogers* S.C., (with him, *M Janisch*)

Attorneys for the Appellants: Jan S. De Villiers

Counsel for the Respondent: *A.R Bhana* S.C., (with him, *J. Boltar*)

Date of hearing: 17th March, 2009

Date of Judgment: 14th May, 2009