9/71

J. 219.

G.P.-S.33967—1968-69—1,000.

In the Supreme Court of South Africa.
In die Hooggeregshof van Suid-Afrika.

(APPELLATE Provincial Division.)
(Provinsiale Afdeling.)

9/71

Appeal in Civil Case.
Appèl in Siviele Saak.

HERON INVESTMENTS (PTY) LIMITED *Appellant,*

versus

SECRETARY FOR INLAND REVENUE *Respondent*

Appellant's Attorney Kalil & Dennis Nathan *Respondent's Attorney* D.F. SA Lombaard
Prokureur vir Appellant *Prokureur vir Respondent*

Appellant's Advocate H Rochschild SC *Respondent's Advocate* B. O'Donovan S.C
Advokaat vir Appellant A.J Sweatey *Advokaat vir Respondent* C.J.M. Hathorn

Set down for hearing on
Op die rol geplaas vir verhoor op 24-5-1971

1.3.5.6.7.

Coram Ogilvie Thompson CJ. Rumpff,
Jansen, Trollip et Rabie JJ.A.

TITSC 9.45 am —— 11.00 am
11.15 am —— 12.30 pm

C.A.V.

Judgment 2.5.1971 per Ogilvie Thompson CJ.
appeal dismissed with costs
to include the costs of 2 counsel

[signature]

SUPREME COURT,
GRIQUALAND,
BLOEMFONTEIN.
- 2 - 1971

Writ issued Lasbrief uitgereik	Bills Taxed.—Kosterekenings Getakseer.		
	Date. Datum.	Amount. Bedrag.	Initials. Paraaf.
Date and initials Datum en paraaf			

IN THE SUPREME COURT OF SOUTH AFRICA.
(APPELLATE DIVISION)

In the matter of -

HERON INVESTMENTS (PTY.) LTD. ..... Appellant

versus

SECRETARY FOR INLAND REVENUE ..... Respondent.

Coram: OGILVIE THOMPSON, C.J., RUMPFF, JANSEN, TROLLIP et RABIE, JJ.A.

Heard: 24th May 1971. Delivered: 2nd August 1971

J U D G M E N T.

OGILVIE THOMPSON, C.J.:

Appellant appeals direct to this Court - the consents required in terms of sec. 86 (1) (b) of the Income Tax Act (No. 58 of 1962) having been duly filed - against the decision of the Transvaal Special Court dismissing appellant's appeal against assessments for normal tax for the years of assessment ended 30th June 1965 and 30th June 1966. The aforesaid appeal was directed against respondent's refusal to allow any portion of two amounts

of...../

of R36548 and R7302, expended, in the circumstances hereinafter detailed, by appellant in making alterations to a building, known as Price Forbes House, owned by it, as deductions against appellant's gross income for the tax years 1965 and 1966 respectively.

Upon an examination of the facts of the case in the light of the principles set out in New State Areas Ltd. v. Commissioner for Inland Revenue, 1946 A.D. 610, and Secretary for Inland Revenue v. Cadac Engineering Works (Pty.) Ltd., 1965 (2) S.A. 511 (A.D.), the Special Court came to the conclusion that the expenditure upon the alterations claimed by appellant to be deductible must be regarded as capital expenditure and that it was, therefore, inadmissible for deduction in terms of sec. 11 (a) of the Act. Appellant's appeal to the Special Court was, accordingly, dismissed.

It is not disputed that the expenditure in issue was incurred exclusively for the purposes of trade and in the production of income. The sole question for

decision..../

decision by this Court is, accordingly, whether or not the said sums of R36548 and R7302 - or any portion of them - constituted expenditure of a capital nature and were, therefore, rightly held to be inadmissible for deduction under sec. 11 (a) of the Act. It may at once be mentioned that during the 1965 and 1966 tax years appellant incurred certain expenditure in respect of repairs to Price Forbes House, which said expenditure was allowed as a deduction under sec. 11 (d) of the Act. Although certain of the items included in the aforementioned amounts of R36548 and R7302 might, if adequately specified, conceivably also have been admissible for deduction under sec. 11 (d) of the Act, no such claim was advanced. We were informed that it was not possible to achieve a satisfactory break-down of the amounts now claimed in so far as they might include repairs stricto sensu. In the present proceedings appellant's claim for deduction is accordingly restricted to a claim under sec. 11 (a) of the Act.

Appellant is a private company whose income consists mainly of rentals derived from the letting of fixed

property /

property. Appellant is the owner of consolidated stand no. 557, situated at the corner of Frederick and Sauer Streets, Marshalltown, Johannesburg, on which Price Forbes House was erected in 1956. This building is on the southern fringe of the central business area of Johannesburg and consists of a basement, a ground floor, and eight additional floors. The cost of the land and the building was approximately R550000. In October 1956 and while the building was still being erected, Price Forbes (Africa) Ltd., a firm of insurance brokers and to whom I shall hereafter refer as "Price Forbes", concluded with appellant a written lease of the 4th, 5th and 6th floors of the building together with two kitchens and a store room on the mezzanine floor. The rental for the premises so hired was R1911 per month, subject to adjustment in regard to municipal rates. The period of the lease was 9 years and 11 months. It was at the request of Price Forbes that the building, when completed, was given the name of Price Forbes House.

During 1964 - that is to say, while the original

lease...../

lease had still some 2 years to run - Price Forbes advised the appellant that it had been offered other premises and requested to be released from the contract of lease. At that time the letting of office accommodation in Johannesburg was difficult; other buildings nearer to the business centre of Johannesburg than Price Forbes House were standing with several floors unrented. Appellant, being anxious not to lose Price Forbes as a tenant, accordingly entered into negotiations in an endeavour to induce it to remain and also intimated its willingness to alter the leased premises to suit Price Forbes's requirements. These negotiations proved successful. Appellant agreed to make the alterations required by Price Forbes and the latter concluded a new lease with appellant on 8th December 1964 for a period of 9 years and 11 months commencing 1st December 1964. The premises thus leased were the same as those which were the subject of the earlier lease plus a portion of the 3rd floor of the building. The rental agreed upon was R2350 per month throughout the period of the lease. As had been the case under the previous lease, the rent was

calculated at the rate of 10 cents per square foot. The effect of this was that appellant acquired an additional 2 cents per square foot for that portion of the 3rd floor now hired by Price Forbes and for which appellant had previously received 8 cents per square foot. Incorporated in the aforementioned figure of R2350 was an amount of R139 which was intended to cover a possible increase in municipal rates and taxes over the period of the lease. It would appear that some such increase has since supervened. So far as is material to this appeal, clause 5 of the new lease of 8th December 1964 reads:

> "5. In order to suit the requirements of the Lessee, the Lessor shall proceed forthwith to effect, and to complete the same as soon as possible, certain alterations to the leased premises, which shall be as mutually agreed upon between the Lessor and the Lessee. The cost of such alterations shall be borne by the Lessor, provided however, that in the event of the Lessee for any reason whatsoever giving up occupation of the leased premises at any time before the first day of December, 1979, a sum equivalent to one-third of such cost shall be borne by the Lessee and paid by it to the Lessor when the Lessee so gives up occupation."

This clause was the result of a compromise between, on the

one...../

on the one hand, appellant's endeavours to obtain a 15 year lease coupled with its reluctance to undertake extensive alterations for a 10 year lease and, on the other hand, Price Forbes's unwillingness to bind itself for more than a 10 year period.

The alterations to the leased premises made by appellant pursuant to its aforementioned agreement with Price Forbes consisted of the creation of larger and more modern offices by removing certain of the brick and plaster inner walls and substituting therefor demountable partitions. Consequential alterations were the changing of electrical lights and electrical points, the reconstruction of existing fittings and the installation of new linoleum flooring. In addition, double windows were fitted and 6 air conditioning units were installed; panelling of executives' offices, and of portions of the landings, was also done. The aforementioned demountable partitions consisted of a solid base, approximately 6 foot 6 inches in height, with glass louvres superimposed to afford light and ventilation. According to the statement of case, demountable partitions

are...../

are more expensive than brick walls of similar dimensions. The statement of case also records, as agreed facts: (i) that the general tendency in the construction of modern office blocks is to instal demountable partitions rather than brick and plaster walls, since these partitions facilitate any alterations of lay-out that may subsequently be required; (ii) that commercial firms prefer demountable partitions as conveying an impression of a more modern building; but that some types of tenant - e.g. banks and medical practitioners - require sound proof offices and accordingly insist upon interior walls made of brick; and (iii) that, having installed the demountable partitioning, appellant hoped that, on termination of the new lease with Price Forbes, market conditions at that time would not make it necessary to replace the partitioning by brick walls as the cost of such replacement will be very high.

The aforementioned amount of R36548 claimed as a deduction in the 1965 tax year was made up as follows:

a)...../

" a) Demountable partitions, fixed complete, including doors, door handles and locks, glass and glass louvres R15,714

b) Electrical installation, including new and special light fittings 4,759

c) Air conditioning units 1,904

d) Secondary timber window frames 671

e) Reconstruction and building in of existing fittings and shelves 200

f) Indoor plants 60

g) Wallpaper 100

h) Linoleum flooring 3,318

i) Panelling 1,044

j) Painting 5,815

k) Architects' fees 2,023

l) Contingencies 940

R36,548 "

The R7302 claimed as a deduction in respect of the 1966 tax year is not itemised in the record before us, but this figure represents the cost of the installation of new materials such as partitioning, linoleum flooring, pavelite flooring, wallpaper, electrical equipment and wall skirtings; it also included the sum of R456 in respect of painting. In addition to the above, certain

other.../

other alterations were effected to the leased premises at a total cost of R4123 paid by Price Forbes.

The expenditure upon air conditioning units (R1904), secondary timber window frames (R671), and on indoor plants (R60) were, both in the Special Court and in this Court, conceded by the appellant to be of a capital nature, and thus to be inadmissible for deduction. It is recorded as an admitted fact in the statement of case that there was no increase in the value of the building as the result of the alterations, save in regard to the installation of air conditioning. Further, it is likewise recorded that a landlord is usually entitled to demand increased rents for areas which have air conditioning. In the course of delivering the Special Court's judgment, the learned President (Galgut, J.), remarked that:

> "There is no doubt on all the evidence that the alterations in this building constitute an improvement, even though they may not have added to the actual value of the building".

The learned President also said the following:

"The...../

> "The evidence indicates that it is quite a usual procedure for a building owner when erecting his building to arrange the accommodation on certain floors to suit the prospective tenant. It appears also that even in a building which is already in existence alterations will in certain cases be done by a landlord to suit a good tenant. It is obvious that the nature of the alterations and the extent thereof will depend on the standing of the tenant and the period of the lease which is to follow".

The statement of case mentions that appellant had on two previous occasions carried out alterations to suit Price Forbes at the latter's request, and that appellant recouped the cost of these alterations by way of increased rental. The statement of case also contains the following passage, viz:

> "It is not unusual for a landlord to effect alterations to suit a tenant whom he may wish to have or retain".

In support of the contention that the expenditure in issue was of a revenue character, counsel for appellant stressed this last-cited passage in the stated case, and emphasised that - except for the conceded items relating to air conditioning, window frames and plants - the alterations, on the Special Court's findings, neither increase the value

of..../

of the building nor enhance its income earning potential. These features, said counsel for appellant, show the expenditure in question to be of a recurrent nature; and he went on to submit that the alterations in issue were undertaken solely in order to facilitate the letting of the premises to Price Forbes and that, properly regarded, the expenditure incurred in making the alterations neither added anything to, nor equipped, appellant's income earning structure, but was merely incidental to the performance of appellant's income producing operations. The expenditure, so the submission concluded, did not bring into existence any asset or advantage for the enduring benefit of appellant's trade, but was incurred in working appellant's source of profit.

I am unable to regard the above-cited passage, relied upon by counsel for appellant, as establishing that it is a normal incident of the business of letting business premises for landlords to effect alterations of the magnitude of those presently under consideration in order to acquire new, or to placate existing, tenants.

The passage from the Special Court's judgment last-cited above accords no significant assistance to such a contention. In my opinion, the record before us discloses no real support either for any such aforementioned incident or for regarding the expenditure in issue to be of a recurring nature as submitted by counsel for appellant. The circumstances of the present case are entirely different from those which obtained in the cases of B.P. Australia Ltd. and Mobil Oil of Australia Ltd. v. Commissioner of Taxation of the Commonwealth of Australia, 1965 (3) All E.R. 209 (P.C.) and 225 (P.C.) upon which counsel for appellant sought to place some reliance.

Submitting that the alterations, extensive though they admittedly are, were all substantially consequential upon the installation of the demountable partitions, counsel for appellant argued that there had been no addition whatever to the structure of the building. While this is in a sense quite true, the leased premises as thus newly equipped remain, of course, in the ownership of appellant, and sight must not be lost of the modernisation aspect. If and when Price Forbes vacate, there will

presumably...../

presumably be tenants who require - as Price Forbes required - offices equipped in this manner. Having regard to the increase in rates which has already occurred, the aforementioned amount of R139 incorporated in the aggregate of the rental payable by Price Forbes under the new lease, and the slightly higher income obtained by appellant for the portion of the third floor leased by Price Forbes under the new lease, may, I think, safely be ignored. Similarly as regards any future potential increase in rental derivable from the installation of air conditioning. Nevertheless, assuming in favour of appellant that the alterations in no respect whatever increased the value of the building or enhanced its income earning potential, that assumption is not, in my opinion, of any particular assistance to appellant. For it is clear that appellant's primary purpose in causing the alterations to be made was to retain, in the tenants' market then prevailing, Price Forbes as its lessee under the new lease for a further 10 years and, indeed, as appellant hoped,

for...../

for an additional 5 years thereafter. The provision in clause 5 of the new lease that Price Forbes would bear one third of the cost of the alterations if it gave up occupation before 1st December 1979 would manifestly tend to operate as an inducement for Price Forbes to remain for the full 15 years. The position, as revealed in the record before us, simply was that Price Forbes had intimated its desire to vacate and, as a condition of agreeing to sign a new lease, insisted upon the alterations being made. In short, Price Forbes would continue as tenants only if that portion of the building which they hired was equipped in conformity with their requirements. The expenditure incurred by appellant in effecting the stipulated alterations was made "once and for all", and there was a complete absence of any element of recurrence in relation to this expenditure. As already mentioned, appellant actually stood to recover a third of the expenditure in the event of Price Forbes vacating before 1st December 1979.

Under...../

Under all the circumstances, the expenditure in issue cannot, in my opinion, rightly be said to form part of the performance of appellant's income earning operations. I can find no sufficiently close link (see Commissioner for Inland Revenue v. Genn & Co. (Pty.) Ltd., 1955 (3) S.A. 293 (A.D.) at 299) between that expenditure and such last-mentioned operations as to render the expenditure part of the working of appellant's source of profit. On the contrary, the true view appears to me to be that appellant incurred the expenditure in question in order to equip its income earning structure - the portion of the building leased to Price Forbes - in order to obtain the rental income paid by Price Forbes for the substantial period of the new lease.

Furthermore, the alterations, in addition to modernising that portion of the building let to Price Forbes, were designed to bring, and actually brought, appellant the advantage, despite the then prevailing tenants' market, of a lease by an approved and desirable

tenant for a substantial period. That, indeed, was, as already mentioned, appellant's main purpose in effecting these alterations. In my opinion, the advantage so sought and obtained by appellant was, in relation to appellant's business of letting this building, an "advantage for the enduring benefit of a trade" within the meaning of that oft-quoted expression as explained in Secretary for Inland Revenue v. John Cullum Construction Co. (Pty.) Ltd., 1965 (4) S.A. 697 (A.D.) at pp. 712 - 714.

The various considerations I have mentioned lead, in my opinion, irresistibly to the conclusion that the expenditure incurred by appellant in making the alterations in issue was of a capital nature, and that the decision of the Special Court was, therefore, correct in law.

For the aforegoing reasons, the appeal is dismissed with costs, such costs to include the fees of two counsel.

N. Silvia Thomas

RUMPFF, J.A.)
JANSEN, J.A.)
TROLLIP, J.A.) Concur.
RABIE, J.A.)