

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

(APPELLATE

Provincial Division)
Provinsiale Afdeling)

Appeal in Civil Case
Appel in Siviele Saak

SECRETARY FOR INLAND REVENUE

Appellant,

VERSUS

SAFRANMARK (PTY) LTD

Appellant's Attorney

Prokureur vir Appellant

SA BLOEMFONTEIN

Respondent's Attorney

Prokureur vir Respondent

Respondent

HOLMES BLOOM + VENNET

Appellant's Advocate

Advokaat vir Appellant

Respondent's Advocate

Advokaat vir Respondent

Set down for hearing on

Op die rol geplaas vir verhoor op

17 8 81

(ITSC)

Coam: Janes; Corbett; Miller AER +

Holmes + Molyneux AER

(3 6 8 14 16)

De Appellant: PH Tibbutt & J J Loxcroft

De Respondent: E B Bloembergen

Tibbutt: This - This is the other side

Bloembergen: This is the other side

Tibbutt: This is the other side

WITSPRAAK 28 7 81 HOF 1 Q 9 000

Writ issued
Lasbrief uitgereik

Date and initials
Datum en paraaf

Bills taxed - Kosterekenings getakseer		
VIR HOF AER 28 7 81 HOF 1 Q 9 000		
Date Datum	Amount Bedrag	Initials Paraaf

IN THE SUPREME COURT OF SOUTH AFRICA
(APPELLATE DIVISION)

In the appeal of :-

THE SECRETARY FOR INLAND REVENUE appellant

versus

SAFRANMARK (PROPRIETARY) LIMITED respondent

Coram: JANSEN, CORBETT, MILLER JJA, HOLMES et GALGUT AJJA

Date of Hearing: 17 August 1981

Date of Judgment: 28 September 1981

J U D G M E N T

CORBETT JA:

The simple issue in this case is whether during the relevant years of assessment the operations of respondent, at its different outlets, in the production of what is known as Kentucky Fried Chicken constituted a "process of manufacture" within the meaning of that phrase as used

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in the context of sec 12 of the Act (or similar statutory provisions in earlier legislation) has been considered in a number of cases in the Income Tax Special Courts, and also by this Court in Secretary for Inland Revenue v Hersamer (Pty) Ltd, 1967 (3) SA 177 (AD). Most of these cases are referred to in the judgment of MILLER J (as he then was), given as President of the Natal Income Tax Special Court in Income Tax Case No 1247, 38 SATC 27, at p 31. I think that from these previous decisions certain general propositions may be derived. They are :

- (1) The term "process of manufacture", in the present context, denotes an action or series of actions directed to the production of an object or thing which is essentially different from the materials or components which went into its making.
- (2) The requirement of "essential difference" necessarily imports an element of degree; and there are no fixed criteria - nor is there any precise universal

/ test.....

test - whereby it can be determined whether or not a change in the materials or components wrought by the process, be it as to the nature, form, shape or utility of the materials or components, has brought about an essential difference. This must be decided on the individual facts of each case.

- x a
- (3) When deciding whether a particular activity does or does not fall within the ambit of a "process of manufacture" the ordinary, natural meaning of that phrase in the English language must not be lost sight of. And in this connection analogies can be misleading. Thus to analyse and extract from a process or operation which indubitably amounts to a process of manufacture general criteria or attributes and to conclude that another process to which the same general criteria apply or which exhibits similar general attributes is, therefore,

/ also.....

also a process of manufacture may lead to results not intended by the Legislature, particularly where it would be inaccurate or unrealistic in normal parlance to describe the latter process as a process of manufacture. (See in this regard Income Tax Case No 1247, supra, at p 32; and the Australian case of M P Metals (Pty) Ltd v Federal Commissioner of Taxation, 14 ATD 407, a decision of WINDEYER J in the High Court, confirmed on appeal, see 14 ATD 540.)

Basically the operation conducted at respondent's outlets consists of cooking pieces of chicken for the purpose of sale to the public. This entails storing the pieces of cut chicken with which respondent is supplied, preparing them and cooking them. In my opinion, this operation or process does not result in the production of an object or thing which is essentially different from the materials or components which went into its making. It is true that in a certain sense cooked chicken is

/ different.....


different from raw chicken. No doubt certain chemical changes take place, although the evidence did not disclose what these are. More importantly the public eat cooked chicken and, generally speaking, do not eat raw chicken. So there is a change in the utility of the article. But this is common to all processes of cooking. I cannot, therefore, think that the cooking of chicken at respondent's outlets produces articles so different from the materials used as to amount to a process of manufacture. I also do not believe - and this is necessarily very much a matter of impression - that what one normally and naturally understands by the phrase "process of manufacture" comprehends the production of cooked pieces of chicken from raw pieces of chicken.

Nor do I think that this conclusion is affected by the fact that there are certain additives in the cooking - the so-called "milk and egg dip" and the "breeding mix", including the secret spice mixture - or by the fact that a

/ standardised.....

standardised product is produced or by the fact that Kentucky Fried Chicken is produced and sold on a large scale. Cooking normally involves the introduction of additives. And if a particular operation does not constitute a process of manufacture, then I do not see how it can become one merely by being conducted on a large scale or merely because it results in a standardised product.

I would allow the appeal with costs and alter the order of the Court a quo to read: "Appeal dismissed".



M M CORBETT

IN THE SUPREME COURT OF SOUTH AFRICA

(APPELLATE DIVISION)

In the appeal of:-

THE SECRETARY FOR INLAND REVENUE.....appellant

versus

SAFRANMARK (PROPRIETARY) LIMITED respondent

Coram: JANSEN, CORBETT, MILLER JJA, HOLMES et GALGUT AJJA.

Date of Hearing: 17 August 1981

Date of Judgment: 28 September 1981

J U D G M E N T

GALGUT AJJA

This is an appeal from a decision of the Cape Income Tax Special Court (the Special Court). It was brought direct to this Court pursuant to an order made, in terms of section 86A (5) of the Income Tax Act 58 of 1962 ("the Act"), by the learned Judge who presided in that Court.

/ The

The respondent SAFRANMARK (Pty) Ltd ("SAFRANMARK") holds a franchise from Kentucky Fried Chicken SA (Pty) Ltd ("Kentucky") to prepare and sell fried chicken in a manner specified by Kentucky. For the years of assessment ended 31 May 1974, 1975 and 1976 SAFRANMARK submitted returns of its income. In each year it claimed the "machinery initial allowance" in terms of subsection 12(1) of the Act and "the machinery investment allowance" in terms of subsection 12(2). The Secretary for Inland Revenue ("the Secretary") disallowed the deductions, added them back to SAFRANMARK's income and issued assessments on that basis. SAFRANMARK's objections to these assessments having been disallowed, SAFRANMARK noted and lodged an appeal to the Special Court. That Court decided that the Secretary should have allowed the deductions claimed. The Secretary now asks this Court to reverse that ruling.

The relevant statutory provisions are subsections

/ (1) and.....

(1) and (2) of section 12 of the Act. These subsections were substituted by subsections 15(1)(a) and 15(1)(c) of Act 85 of 1974. There have been subsequent amendments which are not relevant to the appeal. The subsections as substituted by Act 85 of 1974 are applicable to the 1975 and 1976 tax years. However, in so far as the 1974 tax year and the issues in this appeal are concerned, the wording of subsections 12(1) and 12(2), prior to the substitution, was for all practical purposes the same.

Subsection 12(1) allows a deduction in respect of "new and unused machinery or plant brought into use by the taxpayer for the purposes of his trade..... and is used by him directly in a process of manufacture or any other process which in the opinion of the Secretary is of a similar nature.....". This deduction is allowed for the year of assessment during which the machinery or plant is so brought into use and is known as "the machinery initial / allowance"

allowance".

Subsection 12(2) provides that, subject to certain exceptions which are not relevant to the appeal, "there shall further be allowed to be deducted..... for the year of assessment during which such machinery or plant is so brought into use an allowance to be known as a machinery investment allowance".

It will be seen that the machinery initial and investment allowances are deductible if —

- (i) the machinery or plant is new and unused;
- (ii) it is brought into use for purposes of the taxpayer's trade during the year of assessment;
- (iii) it is used directly in a process of manufacture; or alternatively to (iii),
- (iv) if it has been used directly in a process which in the opinion of the Secretary is of "a similar nature" to a process of manufacture.

No difficulty arises as to (i) and (ii) above.

These requirements, it is accepted, have been fulfilled.

As to (iv) above, the Secretary advised that in his opinion the process is not similar to a process of manufacture. His opinion in this regard was not challenged and is therefore not in issue. It was common cause that the plant and machinery were used directly in the operations of SAFRANMARK. Thus the sole issue before us is whether the operations conducted by SAFRANMARK can be said to have been a process of manufacture. The Special Court held that they were.

In support of its contention that its operations constituted a process of manufacture SAFRANMARK led evidence before the Special Court detailing the procedure, which it (and all Kentucky franchise-holders) followed and was obliged to adhere to, from the time the raw product, i.e. the chicken, or broiler as it was also called, is received by the franchise-holders till the fried chicken is sold to the customer. Details were also given of the machinery and plant used. A summary of this evidence follows.

The chicken and other ingredients

There is only one supplier of chickens to franchisees of Kentucky. Cases of chicken are supplied to each outlet. The chickens are packed in polythene bags, two chickens to a bag. Each chicken is cut up into nine pieces, viz, two wings, two drum sticks, two thighs, two side breasts and one centre breast. The chickens must arrive frozen and ice-packed at a temperature of between 32°F and 34°F. The weight of each chicken must be between 1050 grams and 1150 grams. The date of kill must be stamped on each polythene bag and each chicken must be cooked within 6 days of slaughter.

On arrival at the outlet, i.e. the franchisee's premises, the above temperatures and weights are checked.

The chickens are then stored in a "walk-in cooler", the temperature of which must be checked daily and maintained at 33°F. The franchisee, using previous sales as a guide,

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then estimates how much business he will do on the next day. The required number of chickens is then taken out of the walk-in cooler and allowed to defrost. The chicken is then taken out of the bag and treated in a certain way to remove all the animal fat, giblets and feathers. The thigh bones are broken. Each piece has a specific way of being cleaned. The chicken is then put into a new bag and eight bags are put into a case. The case is then put back into the walk-in cooler. It is taken out of the cooler an hour before the cooking process begins. The chicken is then allowed to thaw to a given temperature. It is then dipped into a "milk and egg dip". Thereafter it is rolled in a "breeding mix" in a bin, which mixture consists of flour containing certain herbs and spices. The spice mixture is a secret. The chicken, which is then ready to be put into the pots, is put onto a screen called a slide tray.

The machinery and plant

In addition to the thermometer, scale, walk-in

/ cooler.....

cooler, slide trays and bin, the following are used:
cooking pots, a gas stove, a dump table, a filtering screen
and a baffle tank.

Depending on the estimated demand anything from
one to twenty pots are used. These pots are "special
patented Kentucky Fried Chicken pots" that build up 15 lbs
per square inch pressure and hold exactly 5 litres of
vegetable oil - called shortening - and two chickens,
i.e. 18 pieces of chicken. Each pot has a special thermometer
which fits inside the pot to ensure that the correct speci-
fied temperature is reached. The gas stoves are lit
and the flame is set exactly so that the temperatures rise
at a given rate to a specified temperature. The chicken
is, at the specified temperature, slid from the slide tray
into the pot. Certain steps are taken to ensure that the
pieces of chicken do not stick to each other or to the bottom
of the pot. Special steps are also taken to ensure that
the specified temperatures and pressures are adhered to and
/ that.....

that the chicken is not in the pot longer than the specified time. The pot contains the required quantity of shortening. This oil is specially produced for Kentucky and has precise requirements. When the specified time has elapsed the chicken is removed from the pot and "dumped" onto a special "dump table" so that the oil can drain off from the chicken through a filtering plant into a baffle tank. If the fried chicken is not sold within 2 hours after it has been taken from the pot it is discarded.

The evidence also explains how the shortening is kept pure and gives details of the maintenance of the equipment, especially the pots and thermometers, to ensure that at all times the required temperatures and pressures can be maintained.

The evidence further discloses that Kentucky has 78 outlets in the Republic and that they sell three and a half million chickens a year. It also appears that world wide there are 6 307 such outlets. A retail outlet

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in the Republic employs, depending on the volume of business, from eight to fifteen people. Their particular tasks are set out in the evidence. Of these only one is a salesman.

It is by adhering strictly to all the above procedures, temperatures and weights that the chickens produced by all outlets are exactly the same as to taste, as to tenderness and as to the brownish colour, which, it appears, is a most important factor. This means that no matter from which outlet the customer buys, he will get a standardised product, viz. a Kentucky Fried Chicken.

The following facts are also relevant:-

- (a) SAFRANMARK as a holder of a franchise from Kentucky adhered strictly to the required procedure.
- (b) It had five outlets in 1975 which grew to eleven in 1976.
- (c) The amounts disallowed in the respective years were:-

/ 1974

1974 tax year

Investment allowance	R 9 676
Initial allowance	R 7 604

1975 tax year

Investment allowance	R14 304
Initial allowance	R13 371

1976 tax year

Investment allowance	R 2 667
Initial allowance	R 2 222

If one has regard to the fact that these are the deductible allowances claimed and are percentages of the original cost, it will be realised that the amount expended on the machinery and plant was substantial.

(d) Kentucky insists that all franchise-holders conform to rigid specifications and that they all operate in exactly the same way. To that end it trains managers of franchise-holders and issues a manual of instructions which must be adhered to in every respect. It employs a "Franchise Field Service" representative whose task, inter alia, is to visit

/ franchise-holders.....

franchise-holders periodically to ensure that they adhere to the specifications.

(e) In the result the end product sold by each and every franchise-holder is the same as to size, tenderness, taste and colour. In other words, every customer who orders a Kentucky Fried Chicken receives the identical product no matter from which outlet he purchases it.

(f) The Kentucky Fried Chicken is a take-away food.

Before starting his argument in this Court, counsel for the Secretary applied to amend the notice of appeal. Counsel for SAFRANMARK not only opposed the application but also asked that the appeal be dismissed on the ground that the notice of appeal was a nullity. As to this more later.

The notice of appeal as proposed to be amended reads (my underlining):-

"That the Special Court erred in holding on the facts as disclosed in the evidence

/ that.....

that the operations of the appellant, in preparing fried chickens for sale, constituted a process of manufacture within the meaning of section 12 of the Income Tax Act, 1962 (Act 58 of 1962); in particular the Special Court erred, if and in so far as it found as a fact that the end product was essentially different from its main component."

The notice of appeal in its original form did not contain the underlined words.

Counsel in his objection to the amendment submitted that the notice of appeal in its original form did not comply with the requirements of section 86A (15) of the Act; that accordingly the notice of appeal was a nullity; that its lack of validity could not be cured by an amendment. He then urged that the appeal should be dismissed on the latter ground. There is clearly no merit in that contention.

As stated in Secretary for Inland Revenue v Hersamar (Pty) Ltd, 1967 (3) SA 177 (A) at page 186, the question

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whether on the proved facts, a taxpayer's operations amounted to a "process of manufacture" is a question of law. The notice of appeal in its original form sufficiently sets out the question of law involved. The Court accordingly dismissed the application for dismissal of the appeal based on the alleged invalid notice.

The parties were advised that the Court would decide later whether or not to grant the amendments and directed that the parties argue the appeal as if the amendments had been allowed. In that way the issues raised by the original notice and the amended notice would be covered. We have decided to grant the amendments.

Our reasons can be shortly stated. The first amendment, viz, the insertion of "as disclosed by the evidence" does not broaden the ambit of the appeal. The facts in any given case can only emerge from the evidence. As to the other amendment, the Special Court, as we shall see later,

/ having.....

having considered the decisions in previous cases and the facts before it, stated that the end product is "essentially different from its main component". This statement, if examined in its context, was not a finding of fact but a conclusion arrived at from the facts found by the Special Court. Our courts, in deciding the question of law, as to which see the Hersamer case at the place cited above, have emphasized that there must have been a "substantial or essential change of the character of the materials" out of which the "manufactured" article was made. In this regard it has been said that there can be no fixed criteria as to when any such change can be said to have been effected. A finding that there has been such a change is a conclusion to be drawn from the proved facts. Whether such conclusion was correctly drawn is virtually the question of law which has to be answered. Hence this amendment, which incidentally is hypothetically

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stated, does not really introduce anything of which
 SAFRANMARK was not forewarned. SAFRANMARK could not be
 prejudiced by allowing the amendment.

I turn now to discuss the import of the phrase
 "process of manufacture". As stated by WILLIAMSON JA in
Secretary for Inland Revenue v Hersamar (Pty) Ltd, 1967

(3) SA 177 A at p 186,

"Neither of the governing words in
 the phrase under consideration, viz 'process'
 and 'manufacture', are words of any exact
 significance. Consequently the whole
 phrase, 'a process of manufacture' is one
 to which it may be very difficult to assign
 a meaning expressed in terms which would
 properly distinguish between all cases
 which fall within the scope of the phrase
 and those which should fall outside its
 scope. The word 'process' can cover an
 unlimited multiplicity of types of
 operations: 'manufacture', in its widest
 sense, can be said to mean the making of any
 sort of article by physical labour or
 mechanical power. DARLING J in McNicol
v Finch, (1906) 2 KB 352 at p 361,
 stated that

'the essence of making or manufacturing
 is that what is made shall be/different
 thing from that out of which it is made.'".

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It appears from Income Tax Case No 1247, 38 SATC at p 31, that MILLER J had occasion to examine several income tax cases, including Hersamer's case sup. cit. in which the meaning of "process of manufacture" was considered. I too have considered those cases. I am thus in full agreement with what MILLER J says at p 31:

"That the ordinary connotation of the term 'process of manufacture' is an action or series of actions directed to the production of an object or thing which is different from the materials or components which went into its making, appears to have been generally accepted. The emphasis has been laid on the difference between the original material and the finished product."

and at p 32:

"Invariably, in cases in which plant or machinery has been found to have been used in a process of manufacture, the result of such process has been the creation of a substance or an article which, although it might have contained all the various components from which it evolved in the process of manufacture, became upon completion an essentially different entity in its own right."

/ WILLIAMSON.....

WILLIAMSON JA also had occasion in Hersamar's case sup. cit. to consider previous tax cases in which "process of manufacture" was interpreted. He points out at page 187 that -

"Some judicial dicta seem to emphasise 'a change of the character of the raw materials' out of which something is made. Others again state that the 'difference' must be 'substantial' or 'essential'

and goes on to say that the term "essential"

"obviously imports an element of degree into the determination of the sufficiency of the change that must be effected for a process to be one of 'manufacture'. As a result of being processed, a change may take place in regard to the nature or form or shape or utility, etc., of the previous article or material or substance. There can be no fixed criteria as to when any such change can be said to have effected an essential difference. It is a matter to be decided on the particular facts of the case under consideration. The most exhaustive examination of imaginary examples of change really does not carry the matter further."

/ The.....

The Shorter Oxford English Dictionary (1978 edition)

gives the meaning of the noun manufacture as:-

"(a) The action or process of making by hand; (b) the making of articles or material (now on a large scale) by physical labour or mechanical power."

The meaning of the verb manufacture is given as:-

"(1) To work up (material) into forms suitable for use; (2) to produce by labour (now especially on a large scale)".

These dictionary meanings are extremely wide and cover a very large field. They certainly do not lend support to the Secretary's contention. I do not find the dictionary meaning helpful in resolving the issue before us.

It was not suggested that the procedures adopted by SAFRANMARK did not amount to a process. The evidence established a continuous and regular succession of actions carried on in a definite manner and which produced the desired result. The issue thus is: did the process amount to one of manufacture?

The submissions made by counsel for the Secretary

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can be summarised. He urged that there had not been any substantial or essential change in the main ingredient; that Kentucky Fried Chicken was still chicken; that one speaks of cooking or frying chicken and not of manufacturing fried chicken; that to regard cooking or frying chicken as a process of manufacture was to "wrest the word manufacture from its ordinary and plain meaning and that there was no justification for thinking that the Legislature intended to use it in any but its ordinary meaning"; that the procedures and operations insisted upon by Kentucky were for quality control and not to produce a manufactured article.

I pause to say that I do not find analogous cases helpful in deciding the issue before us.

An examination of the procedures and operations carried on by SAFRANMARK demonstrate —

(aa) that plant and machinery is used and

which in some respects is specialised;

/ (bb) that.....

- (bb) that the method of using the plant and machinery is standardised;
- (cc) that human effort and labour are used;
- (dd) that the volume of production is based on anticipated demand;
- (ee) that the volume of production is large;
- (ff) that the end product is different from the materials from which it is produced not only in nature but also in utility and value in that the ingredients of the milk and egg mixture and of the breeding mixture have ceased to exist and the inedible raw chicken has become an edible product.
- (gg) that all the above was done for the purpose of SAFRANMARK's trade.

The conclusion to be drawn from the above is that not only did each of the ingredients cease to retain

/ its.....

its individual qualities but upon completion of the process a different compound substance having a special quality as such, viz. edibility and special taste, has been produced and moreover produced in quantity for purposes of trade. If one adds to the above conclusion the scale on which the operations were conducted and the large volume of sales which were effected, it will be seen that the above submissions by counsel cannot be sustained.

I do not deem it necessary to repeat what was said by WILLIAMSON JA in the Hersamer case cited above at pages 186 and 187 and by MILLER J in Income Tax Case No 1247 (supra) at pages 31 and 32. It is sufficient to say that if regard is had to the tests applied in those cases it will be seen that what is said in (aa) to (gg) above and the conclusion to be drawn therefrom is that the

/ operations.....

operations of SAFRANMARK constitute a process of manufacture. The detailed process evolved, prescribed and insisted upon by SAFRANMARK was calculated to result in a new and distinctive product recognizable as such and the evidence shows that that has been achieved. The circumstance that what is fundamentally involved in the production is the cooking or frying of raw chicken is not a bar to acceptance of the process as one of manufacture.

In conclusion I wish to add that I find myself in respectful agreement with the following dicta of the learned Judge of the Special Court:-

/ "Is

"Is this process one of 'manufacture'?

In answering this question in the circumstances of the present case one should not, it seems to me, have regard only to the extent of the change which the appellant effects to the materials or components used by it. I should, for instance, hesitate to say the effects of a cordon bleu chef can be described as 'manufacture', even although his creations may be much more elaborate or extravagant than those of the appellant. And although in previous cases the emphasis in deciding whether a process is one of 'manufacture' has been laid on the difference between the original material and the finished product, I do not read these cases as suggesting that this is the only relevant factor, or as purporting to lay down a comprehensive definition which is universally applicable. The expression 'a process of manufacture' is not a term of art. In its ordinary meaning there are features other than the difference between the original material and the finished product which could in particular circumstances determine whether a process is one of 'manufacture' or not. In the present case it seems relevant to me that a standardised product is produced on a large scale by a continuous process utilising human effort and specialized equipment in an organised manner. When to that is added the factor that the end product is, in terms of its nature utility and value, essentially different from its main component, the

/ process.....

process must, it seems to me, be
described as one of manufacture."

In the result the appeal fails and is dismissed
with costs.

O. Galgut
O GALGUT.

JANSEN JA)
MILLER JA) CONCUR
HOLMES AJA)