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Case No 416/86

IN THE SUPREME COURT OF SOUTH AFRICA

(APPELLATE DIVISION)

In the appeal of:

EDGARS STORES LIMITED..... appellant

and

COMMISSIONER FOR INLAND REVENUE respondent

CORAM: CORBETT, HOEXTER, VIVIER JJA, VILJOEN et NICHOLAS AJJA

DATE OF HEARING: 19 May 1988

DATE OF JUDGMENT: 31 May 1988

J U D G M E N T

CORBETT JA:

I have read the judgment prepared by my Brother Nicholas in this matter. Unfortunately I am not able to agree with the conclusion reached by him. In my view, the appeal should be dismissed. Here are my reasons.

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The background facts are to be found in my Brother's judgment and also in the reported judgment of the Court a quo (at 1986 (4) SA 312 (T)). I, therefore, need not repeat them.

As my Brother has pointed out, the case hinges on the application of the general deduction formula in sec 11(a) of the Income Tax Act 58 of 1962 — and more particularly the words "expenditure.... actually incurred ...." (Afrikaans text: "onkoste... werklik....aangegaan") appearing therein — to the rentals paid or payable by the appellant in respect of the various business premises hired by it. In the recent case of Nasionale Pers Bpk v Kommissaris van Binnelandse Inkomste, 1986 (3) SA 549 (A), this Court had occasion to consider the meaning of these words in sec 11(a) and at page 564 A-C Hoexter JA stated the position as follows:

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> "Dit is 'n bekende grondstelling dat, vir doeleindes van art 11 (a) van Wet 58 van 1962, onkoste werklik aangegaan is in daardie belastingjaar waarin aanspreeklikheid daarvoor regtens ontstaan, en nie (vir geval betaling daarvan later sou plaasvind) in die belastingjaar waarin daadwerklike vereffening van die skuld geskied het nie. Kyk Port Elizabeth Electric Tramway Co v Commissioner for Inland Revenue 1936 CPD 241 op 244 (8 SATC 13); Concentra (Pty) Ltd v Commissioner for Inland Revenue 1942 CPD 509 op 513 (12 SATC 95); Caltex Oil (SA) Ltd v Secretary for Inland Revenue 1975 (1) SA 665 (A) op 674 D-E (37 SATC 1). Die vereiste dat die onkoste 'werklik aangegaan' moet word, het egter tot gevolg dat moontlike toekomstige uitgawes wat bloot as waarskynlik geag word nie ingevolge art 11(a) aftrekbaar is nie. Alleen onkoste ten opsigte waarvan die belastingbetaler 'n volstrekte en onvoorwaardelike aanspreeklikheid op die hals gehaal het, mag in die betrokke belastingjaar afgetrek word."

Thus it is clear that only expenditure (otherwise qualifying for deduction) in respect of which the taxpayer has incurred an unconditional legal obligation during the year of assessment in question may be deducted in terms of sec

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11(a) from income returned for that year. The obligation may be unconditional ab initio or, though initially conditional, may become unconditional by fulfilment of the condition during the year of assessment; in either case the relative expenditure is deductible in that year. But if the obligation is initially incurred as a conditional one during a particular year of assessment and the condition is fulfilled only in the following year of assessment, it is deductible only in the latter year of assessment (the other requirements of deductibility being satisfied).

It is, of course, important in this context to distinguish between (i) expenditure in respect of which the obligation is conditional and remains so during the year of assessment, and (ii) expenditure in respect of which the obligation is or during the year of assessment becomes unconditional, but cannot be quantified until

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after the termination of the year of assessment. The latter situation, with reference to a loss instead of an expenditure, is exemplified by the Rhodesian Appellate Division case of Commissioner of Taxes v "A" Company 1979 (2) SA 409 (R,AD), which was concerned with a loan made by the taxpayer, a merchant banker, to a company which subsequently was placed in liquidation. For portion of this loan, amounting to $72 000, the taxpayer ranked as a concurrent creditor. The taxpayer sought to deduct this amount, as a loss incurred, in the year in which the company was placed in liquidation. At that stage the probabilities indicated that concurrent creditors would receive a dividend of not more than 5c in the $1, which would yield a recoupment to the taxpayer of $3 600. The Court held that, as the loss had been suffered once and for all during the tax year in question, it was deductible even though final quantification thereof, which was dependent on the exact amount of the dividend, could take place

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only after the end of the tax year. It was further held that in the unlikely event of the dividend exceeding 5c, the excess would constitute gross income in the taxpayer's hands in the year in which it accrued. (See particularly p 416 A-E; also article by Mr H Vorster entitled "Unquantified and defeasible expenses incurred in the production of income", 1 SATJ 1, at pp 8-11.)

In the present case counsel were agreed that the crux of the matter was whether the provisions in clause 5 of the standard form of lease relating to a turnover rental created a contingent obligation which was incurred, if at all, only at the end of the annual lease period (as defined in clause 5.2.6 and which I shall call "the lease year") or whether they gave rise to an unconditional obligation the quantification of which took place at the end of the lease year. This is not an easy question — as the differences of judicial opinion in this Court and

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between the Courts a quo demonstrate — but I have come to the conclusion that the former of these propositions is the correct one and that, therefore, the Transvaal Provincial Division ("the TPD") reached a correct decision.

Essentially clause 5, as I see it, provides not for a single rental obligation, as argued by appellant's counsel and as held by my Brother Nicholas, but two alternative rental obligations: the obligation to pay a basic rental or in certain circumstances the obligation to pay a turnover rental. The obligation to pay the basic rental accrues from month to month during the lease year and must be discharged in advance. It is payable "until the nett annual turnover figures in respect of (the) year are available" (clause 5.2.4). The obligation to pay the turnover rental is dependent upon the turnover produced from the leased premises during the lease year

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being such that the turnover rental, as calculated in accordance with the formula laid down in clause 5.2.2., exceeds the basic rental. In that event it replaces the basic rental; otherwise the rental obligation remains one to pay merely the basic rental. This emerges, I think, from :

(1) Clause 5.2, which provides that the —

> "monthly rental payable by the LESSEE to the LESSOR shall be the greater of the amounts as defined in 5.2.1 on the one hand" (ie the basic rental — see clause 5.2.1) "and in 5.2.2 read with 5.2.3, 5.2.4, 5.2.5 and 5.2.6 on the other hand" (ie the turnover rental).

(2) Clause 5.2.3, which provides that —

> "Should the rental calculated in terms of 5.2.2 " (ie the turnover rental) "in any year, after deducting therefrom.... ..... amount to less than the basic rental, then in respect of that year the rental payable shall be as defined in 5.2.1" (ie the basic rental).

(3) Clause 5.2.8 which provides that within 3 months of the end of every lease year the lessee —

/"..... shall .....

> "..... shall pay to the LESSOR the sum due under paragraph 5.2.2 above if applicable" (my emphasis)

and shall deliver to the lessor a statement of the nett annual turnover for the lease year, certified as correct by the lessee's auditors. The words 'if applicable' obviously have reference to the contingency as to whether the turnover rental, as calculated in terms of clause 5.2.2, exceeds the basic rental or not. If it does, then the obligation to pay this turnover rental arises; if it does not, then this obligation does not arise.

It is true that there is no express provision in clause 5 to the effect that, in the event of the turnover rental becoming payable, only the amount by which the turnover exceeds the basic rental, which has in the meanwhile been paid from month to month, is payable or, to put it another way, that the basic rental paid should be set off against the total turnover rental as calculated, but this is clearly implicit in the clause. And indeed this is how the parties have evidently operated

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under the agreement (see the letters written on appellant's behalf, dated 3 July 1980 and 10 November 1981, which speak of the "additional rental" payable in terms of the turnover rental clause).

As pointed out by Ackermann J in delivering the judgment of the TPD in this matter, the case is concerned only with those instances where the lease year ends after the appellant's year of assessment, respondent (the Commissioner for Inland Revenue) having conceded that appellant was entitled to deduct from income in the relevant tax year those portions of the amounts claimed in respect of turnover rental (as eventually quantified) which applied to those leases whose lease year ended on the last day of appellant's tax year (see reported judgment at p 314 G-H). The learned Judge also mentioned (at p 325 B-F) the possibility that even in the case of a lease having a lease year ending after the termination of appel-

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lant's tax year, appellant might be able to establish that the turnover during the portion of the lease year falling within the tax year was of such a magnitude as to bring into operation during the tax year the obligation to pay additional turnover rental, but held that that was not the case presented by the appellant and that, therefore, no view need be expressed on this possibility. Before us appellant's counsel accepted this and argued the case on the premise that the liability to pay turnover rentals under the leases in question had not become apparent before the end of the tax year. I might just add, in case this is not already clear, that this case is only concerned with the appropriate tax year in which the additional turnover rental may be deducted. Its deductibility in one year or the other is not in question.

Before the TPD appellant's counsel postulated four ways in which rental could be determined, the fourth

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being in essence the position under the standard form of lease used by appellant; and argued by analogy from the other three postulates that in the fourth case the turnover rental was in fact expenditure incurred month by month during the tax year. (See reported judgment p 323 C-F.) On appeal before us appellant's counsel advanced the same argument. I do not find such arguments based on analogy at all helpful. In the final resort the case must be decided on its own facts and the fact that, had the appellant arranged its leases differently a different result, from the taxation point of view, might have ensued, seems to me to be beside the point.

To sum up the position as I see it, the standard form of lease makes provision for two alternative rental obligations: one to pay the basic rental and one to pay the turnover rental. Appellant as tenant is obliged to pay whichever of these rentals, each as calculated

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according to a certain formula, is the greater. The basic rental accrues and is paid from month to month in advance. The liability to pay the turnover rental can only be determined at the end of the lease year, when the annual turnover is known. If the turnover is below a certain level, and the turnover rental as calculated is less than the basic rental, then there is no obligation to pay turnover rental. There cannot be a vested obligation to pay nil rental. In that case the obligation to pay the basic rental prevails. If, on the other hand, the turnover level is such that the turnover rental, as calculated, exceeds the basic rental, then the obligation to pay it displaces the obligation to pay basic rental, subject to the lessee not being obliged to pay more than the excess. The obligation to pay turnover rental is thus contingent until the turnover for the lease year is determined at the end of the year. The expenditure re-

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lating to the payment of turnover rental can, therefore, not be regarded as having been actually incurred in a tax year which ended prior to the termination of the lease year. It can, therefore, not be deducted in that tax year.

For these reasons I am of the view that the TPD reached the correct conclusion.

The appeal is accordingly dismissed with costs.

M M CORBETTT

HOEXTER JA)
VIVIER JA) CONCUR.
VILJOEN AJA)