THE SUPREME COURT OF APPEAL
REPUBLIC OF SOUTH AFRICA

JUDGMENT

Case No:731/07

ROBIN FRANK MAGUIRE Appellant

and

COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE Respondent

Neutral citation: *Maguire v The Commissioner For the South African Revenue Service* (731/07) [2008] ZASCA 156 (27 November 2008)

Coram: FARLAM, MTHIYANE, HEHER JJA, LEACH et MHLANTLA AJJA

Heard: 4 NOVEMBER 2008

Delivered: 27 NOVEMBER 2008

Summary: Income Tax – Capital or revenue – Payments in terms of successive agreements in Restraint of Trade made before Act 30 of 2000 operated – whether taxpayer had given up resource in exchange for payments – whether accruals part of taxpayer's gross income.

ORDER

On appeal from: the Tax Court of South Africa, Johannesburg (Satchwell J sitting as President of the Tax Court).

1. The appeal is upheld with costs, including those occasioned by the employment of two counsel.

2. The order of the court *a quo* is set aside and replaced with an order in the following terms:

'(a) The appeal is upheld.

(b) The 1998 assessment and the portions of the 1996 assessment relating to the amounts of R350 000 and R1 250 000 are set aside and referred back to the Commissioner for reassessment on the basis that the amount of R350 000 which accrued to the taxpayer under the 1992 agreement, the amount of R1 250 000 which accrued to the taxpayer under the 1996 agreement and the amount of R3 000 000 which accrued to the taxpayer under the 1998 agreement did not fall within the taxpayer's gross income.'

JUDGMENT

FARLAM JA (Mthiyane, Heher JJA, Leach et Mhlantla AJJA

concurring)

[1] This is an appeal against a decision of the Tax Court for the Transvaal in which appeals brought in respect of an amount of R1 250 000 (which was included in the appellant's income for the 1996 year of assessment) and an amount of R3 000 000 (which was included in his income for the 1998 year of assessment) were disallowed. The judgment of the Tax Court has been reported: see *ITC* 1813, 68 SATC 255.

[2] The amounts in question were paid to the appellant pursuant to two agreements which subjected him to what were described therein as restraints of trade. These agreements, which were concluded in 1996 and 1998 between the appellant and International Latex Products (Pty) Ltd, were preceded by an earlier agreement in virtually the same terms concluded in 1992 between the appellant and another company, Macmed Health Care Limited, when he entered that company's employment, in terms of which an amount of R350 000 was paid to the appellant as consideration for a restraint of trade. The Commissioner for the South African Revenue Services raised a revised additional assessment for the 1996 year against the appellant on the basis that the sums of R350 000 paid to him pursuant to the 1992 agreement and R1 250 000 paid to him pursuant to the 1996 agreement were of an income nature and accordingly subject to income tax. A further revised additional assessment was raised against the appellant for the 1998 year on the basis that the sum of R3 000 000 paid pursuant to the 1998 agreement was also of an income nature.

The Commissioner's contention was that the 1992, 1996 and 1998 agreements were not genuine restraint of trade agreements and that in reality the payments made pursuant thereto constituted remuneration for the appellant's services.

[3] After hearing the evidence of the appellant, who was the only witness to give evidence before it, the Tax Court found that the 1992 agreement contained a valid restraint covenant and that the consideration of R350 000 paid to the appellant was a capital receipt in his hands and therefore not taxable. It accordingly allowed his appeal in respect of that portion of the 1996 assessment which related to the amount of R350 000 paid under the 1992 agreement. The appellant's appeals in respect of the payment of R1 250 000 received under the 1996 agreement and the payment of R3 000 000 received under the 1998 agreement were disallowed and the portion of the additional assessment for 1996, in so far as it related to the payment received by the appellant under the 1996 agreement and the additional assessment for 1998, were confirmed.

[4] As I have said the only witness to testify in the Tax Court was the appellant. Not only was no evidence led to contradict his version but no document was put to him in cross-examination which contradicted his evidence. The court made no adverse credibility findings against the appellant and did not question his evidence that he considered the 1992, 1996 and 1998 agreements to contain genuine restraint of trade covenants and that the consideration he received for each did not represent disguised

remuneration for services rendered or to be rendered. Its reasons for holding that the payment of R1 250 000 made under the 1996 agreement and the payment of R3 000 000 under the 1998 agreement were not payments in restraint of trade and therefore not of a capital nature and accordingly fell within his gross income appear in paras 54 to 80 (at 267B to 272B) of its reported judgment. I shall discuss them after I have summarised the material portions of the appellant's evidence.

[5] The appellant testified that he entered the employ of Macmed Health Care Limited (which I shall call in what follows 'Macmed') in 1992. On joining Macmed he was required to sign a restraint of trade agreement (what I shall call in what follows 'the 1992 agreement'). Among other things, the appellant was restrained while employed in any capacity within what was described as 'the Macmed group' and for a period of two years as from the date of termination of such employment from competing with any business conducted by the Macmed group in the Republic, Botswana, Lesotho, Namibia, Swaziland and Zimbabwe. The expression 'the Macmed group' was defined, inter alia, as meaning 'the Company and all its subsidiaries and associated companies from time to time during the material times contemplated by [the] Agreement'.

[6] The appellant testified that he regarded the provisions of the 1992 agreement as fair and reasonable. He stated that if he had taken up a position or employment with a competitor of the Macmed group and used the information which he acquired while

employed in the group, it would have had a severe effect on the group's business. He testified further that the consideration of R350 000 was paid pursuant to a genuine restraint of trade in order to prohibit him from inflicting damage to the group if he left. He pointed out that he was receiving substantial rewards and remuneration for the services he rendered to the group. He also stated that the payment constituted compensation for what was described in clause 4.2 of the agreement as 'the sterilisation of his income earning ability resulting from the undertaking of such restraints of trade'.

[7] He also referred in his evidence to clauses 4.3 and 4.4 of the agreement which read as follows:

'4.3 The Employee expressly acknowledges, and it is agreed between the parties, that in the event of the breach by the Employee of any of the terms of this Agreement, the Employee shall, within 7 (seven) days of receipt of written notice from the Company, repay to the Company the entire amount of the consideration paid to him in terms of clause 4.1 above, which repayment shall be without prejudice to any other remedies which the Company may have in common law.

4.4 Notwithstanding the terms and conditions hereof, it is agreed that, provided the Managing Director of the Company at the time be a person who is not on the Board of Directors of the Company as at the date of signature hereof, then and in such event should the Employee cease to be employed at such time by the Macmed group for any reason whatsoever, the Employee shall be entitled to refund to the Company the sum of R350 000-00 (Three Hundred and Fifty Thousand Rands) paid in terms of Clause 4.1 in which event he shall be entitled to be released from the provisions of Clause 3.'

[8] The appellant also testified that early in 1996 the Macmed group entered into a joint venture with Kendall International (an

international corporation and a member of Tyco International), described in a document before the court as 'the Kendall Company of South Africa'. The appellant was given the responsibility of setting up this company and became its managing director in April 1996. He acquired knowledge as to Kendall International's manufacturing processes, sourcing and pricing and had complete access to its costs throughout the world.

[9] The key personnel of Macmed and the Kendall Company of South Africa were required to sign restraint agreements pursuant to the creation of the joint venture. This was at the insistence of Mr Len Flynn, who was the international representative for Kendall on the Tyco Corporation. The appellant stated that Mr Flynn was aware that he had already signed the 1992 agreement and was accordingly bound by the restraint contained therein, but that he was uncomfortable with the fact that in terms of clause 4.4 of that agreement the appellant could buy himself out of the restraint for R350 000. As a result of Mr Flynn's concern and the fact that the turnover of the Macmed group of companies had increased substantially the appellant was required to enter into a second restraint of trade agreement, viz the 1996 agreement, the wording of which was almost identical to that of the 1992 agreement. The main differences were (1) that the employer with whom the appellant contracted was International Latex Products (Pty) Ltd, which the appellant described as 'the lead company within the Macmed Consumables Group' and of which he was a director; (2) that the period of restraint, in so far as it was to operate after the termination of the appellant's employment within the Macmed

group, was to be six months; and (3) the consideration for the restraint was R1 250 000, which was also the amount for which in terms of clause 4.4 of the agreement (which was otherwise identical to clause 4.4 of the 1992 agreement) the appellant was entitled to purchase his release from the restraint. The appellant stated that the period of six months was regarded as adequate in the circumstances and that the amount of R1 250 000 was tendered to prevent him from inflicting damage on the company (by which I take it he meant the group).

[10] After the 1996 agreement was concluded the appellant introduced a large number of products into the South African market, acquired valuable information that would have been of great value to a competitor of the Macmed group and negotiated a number of acquisitions and joint ventures between the Macmed group and other key players in the South African medical industry. The turnover of the Macmed group rose substantially during the period from 1992 (when it was about R22 million) to 1996 (when it was about R90 million) and again to 1998 (by which time it was about R456 million). During 1998 the appellant received an offer of alternative employment from the Tyco Corporation, which offered to pay the Macmed group the sums of R350 000 and R1 250 000 to enable the appellant to be released from the restraints imposed by the 1992 and 1996 agreements. The appellant also received another offer to run a syringe plant in the Western Cape. He declined both of these offers. By this time the Standard Corporate and Merchant Bank had, according to the appellant, become heavily involved in the business of the Macmed group and the

Standard Bank, through its pension funds and associated companies, had become a major shareholder in the Macmed group. The Standard Corporate and Merchant Bank representative, Mr Bruce Hempel was concerned that, because of the Standard Bank's financial involvement with the group, the directors (including the appellant) should be, as the appellant put it, 'adequately restrained'. The upshot was that the appellant was offered a further restraint of trade so as to provide the Macmed group with sufficient protection against the appellant's going into competition with it. As a result of this the 1998 agreement was concluded. It also was an agreement between the appellant and International Latex Products (Pty) Ltd. Its terms were virtually identical with those of the 1996 agreement. The main differences were that the period of the restraint after termination of the appellant's employment with the group was two years (as was the case with the 1992 agreement) and the consideration paid for the restraint (which was also the 'buy-out' amount in clause 4.4) was R3 000 000.

[11] The combined effect of the 1992, 1996 and 1998 agreements was that the appellant (if the proviso set forth in clause 4.4 of each of the agreements applied) could obtain his release from the restraints contained in clause 3 of each of the agreements by paying a total of R4 600 000 back to the two companies in the group which had provided the initial consideration for the restraints.

[12] I now return to the reasons given in the judgment of the court

a quo for its decision that the amounts received by the appellant under the 1996 and 1998 agreements 'were not made pursuant to a Restraint of Trade'.

[13] The court stated (in para 55 at 267D) that in giving careful consideration to the 1996 and 1998 agreements it had to follow the 'principle that the court must not merely look at the form of the relevant transaction but also at its real nature' (this being a quotation from the judgment of the Transvaal Special Court in *ITC* 1338, 43 SATC 171 at 175).

[14] The court went on to say (in paras 61 to 65 at 268I-269F):

'61. One looks in vain to the 1996 and 1998 agreements to see what further right or asset the taxpayer undertook to exchange or surrender or sterilise to earn any further consideration which could be characterised capital in nature. The test indicated by Watermeyer CJ in *CIR v Lever Bros and Another* AD 441 at 450 that one should look to the originating cause of receipts or ask what was the "*quid pro quo* which he gives in return for which he receives them" is, with respect, apposite in this case. This test was repeated and applied by Corbett JA (as he then was) in *Tuck* [1988 (3) SA 819 (A)] at 833D: ". . .what was the *quid pro quo* which he gave for the receipt?"

62. The restraints set out in clause 3 of the 1996 agreement and the 1998 agreement are exactly the same as those set out in the 1992 agreement, save as regards the duration of the restraint upon termination of employment. The taxpayer committed himself in 1992 to the surrender of those attributes of his economic *persona* as set out in clause 3 of that agreement. To repeat the same clause in 1996 and 1998 does not constitute a further surrender on his part. These capacities have already been given up. One cannot repeatedly exchange the same asset to the same person but for a different price each time.

63. The taxpayer has given up no additional resource in exchange for the further payments in 1996 and 1998. He has undertaken no supplementary restrictions on his income producing capacity.

64. This view is fortified when noting that the restraints in the 1992 agreement endured during employment and for a period of two years thereafter. However, in the 1996 agreement, the restraint period was reduced to that of six months. There was certainly no sacrifice on the part of the taxpayer. This document, on the basis of which he received the payment of R1,25 million, purported to impose a less onerous restraint period. The 1998 document did no more than confirm the restraint period of two years as set out in the still operative 1992 agreement.

65. It was never contended that the time periods of the restraint, post employment, were cumulative. Neither of the two subsequent time periods were expressed to run from expiry of the time period in the earliest or the next agreement. The trigger to commencement of these time periods was, in each case, termination of the taxpayer's employment. Such trigger never eventuated.'

[15] Later (in paras 68 to 69 at 280A-C) the court said:

'68. . . . the taxpayer relinquished nothing in exchange for these payments. He surrendered nothing at all. There is no capital loss to him as a result of which he received these payments. Absent any exchange there can be no capital receipt to him.

69. If the 1996 and 1998 payments did not constitute consideration for any asset of the taxpayer, then they are quite clearly attempts to "top up" the 1992 consideration paid for the restraints which the taxpayer had given at that time and which still continued. Such augmentation cannot be a capital payment in exchange for restraint undertakings. Not only had such undertakings already been given four years previously but capital payments cannot be made with retrospective effect. It is a principle of tax law that expenditure must be incurred during the year of assessment. Macmed could not therefore in 1996 and thereafter in 1998 make payments for those freedoms which had already

been surrendered in the 1992 year of assessment.'

[16] In para 73 at 270G-H the court said:

'73. It is difficult not to conclude that these documents are no more than off-the-shelf precedents recycled when further sums of money were to be paid to the taxpayer. The terms and conditions of these documents have been shown to be without force of effect. Some of the terms are empty. The documents appear to be meaningless save to provide a vehicle which apparently justified payment of the two sums of money.'

[17] In a portion of his judgment headed 'The Status of these further payments' the court speculated without making a finding as to the nature of the relevant payments. It said (para 78 at 271E-F) that it was 'conceivable that the payments made were to induce the taxpayer to remain in the employ of the Macmed group'; in which case they 'would be retainers'. It was also conceivable, the court said (in para 79 at 271H), 'that these payments might have been considered in the nature of bonuses paid to recognise services already rendered in the course of employment and the contribution which the taxpayer had made in the past to the growth and apparent profitability of the Macmed group.'

[18] The court concluded this part of its judgment by saying (in para 80 at 272A-B) that '[w]ether these payments were to secure future services or rewards in recognition of past services, all of which would fall within the definition of "gross income", this court is not called upon to decide.'

[19] As appears from the extracts of the judgment quoted above, the basis of the court's finding, as was argued by Mr *Marais,* who

appeared for the respondent in this court, was that as the appellant had already disposed of his right to trade freely, to the extent specified in the 1992 agreement, no further right was disposed of under the 1996 and 1998 agreements and that the receipts or accruals of R1.25 million and R3 million were therefore not of a capital nature.

[20] In my view it is important, as the court *a quo* said, not merely to look at the *form* of the transactions but to their real nature. What was the real nature of the transactions? Is it correct that the appellant gave up 'no additional resource in exchange for' the 1996 and 1998 payments?

[21] Before endeavouring to find an answer to these questions it will be appropriate to say something about the way in which payments received as consideration for submitting to a restraint of trade were dealt with in our tax law before para (cA) was inserted into the definition of 'gross income' in s 1 of the Income Tax Act 58 of 1962 by s 13(1)(f) of the Taxation Laws Amendment Act 30 of 2000.

[22] Payments made to an employee in exchange for an undertaking not to compete with his employer, ie payments for agreeing to a restraint of trade,have been held in a series of cases to be of a capital nature. In adopting this approach our courts have been influenced by decisions in the United Kingdom.

[23] The first to which I wish to refer, *The Glenboig Union*

Fireclay Co Ltd v the Commissioners of Inland Revenue 1922 SC (HL) 112, 12 TC 427 (HL), has often been referred to by our courts. The taxpayer, who was a manufacturer of fireclay goods and a merchant of raw fireclay, was the lessee of certain fireclay fields over part of which ran the lines of the Caledonian Railway. In 1911 the railway company exercised its statutory powers to require part of the fireclay to be left unworked (so as not to undermine the railway) on payment of compensation. The House of Lords, dismissing an appeal from the Court of Session in Scotland, held that the compensation received by the taxpayer was a capital receipt, not subject to income tax. Lord Buckmaster said (at 114-5 of the SC report, and at 463 of the TC report):

> 'In truth the sum was paid to prevent the Fireclay Company obtaining the full benefit of the capital value of that part of the mines which they were prevented from working by the railway company. It appears to me to make no difference whether it be regarded as a sale of the asset out-and-out, or whether it be treated merely as a means of preventing the acquisition of profit that would otherwise be gained. In either case the capital asset of the Company to that extent has been sterilised and destroyed . . .'

[24] Lord Wrenbury in his speech also (at 116 of the SC report, and at 465 of the TC report) regarded the compensation as 'the price paid for sterilising the asset from which otherwise profit might have been obtained' and accordingly not subject to income tax. Lords Atkinson, Sumner and Carson concurred.

[25] In another decision of the House of Lords, *Beak v Robson* 1943 AC 352 (HL), 25 TC 33 (HL), to which Mr *Marais* referred us, an amount paid to a director of a company as consideration for agreeing not to compete with the company for a period after the period of five years from the termination of his employment with

the company was held to be not subject to income tax.

[26] In 1952 the English Court of Appeal, in *Higgs v Olivier* [1952] 1 Ch 311 (CA), 33 TC 136, held that an amount of £15 000 paid by a film company to Sir Laurence Olivier for agreeing not to act in, direct or produce any film for anybody other than the company was not a taxable receipt. The agreement had been concluded in connection with the film *Henry V,* which Sir Laurence produced and directed and in which he starred as the principal actor. Among the cases cited by Sir Raymond Evershed MR in his judgment were the *Glenboig* case and *Beak v Robson.* He said (at 317-8 of the Ch report, and at 146 of the TC report):

'I think that there is a true analogy between such an arrangement as that [ie the agreement in the *Glenboig* case not to work the fireclay in exchange for compensation] or between a sale of one of a trader's capital assets and a restrictive covenant of a substantial character entered into by a trader relating to trading.'

[27] Later in his judgment (at 319 of the Ch report, and at 147 of the TC report) he said:

'I think that case *[Beak v Robson]* is useful as an illustration of the kind of approach which should be made in considering the application of the taxing provision to covenants of this character.'

[28] The *Glenboig* case was held to be not capable of being distinguished and was accordingly directly applied in *CIR v Illovo Sugar Estates Ltd* 1951 (1) SA 306 (N). In this case certain portions of the taxpayer's canefields were requisitioned by the military and naval authorities, who agreed to pay compensation for the destruction of cane, the use of the canefields and the cancellation of a lease. Hathorn JP (with whom Carlisle and Selke JJ concurred) held (at 310D) that the canefield was 'an essential

part of the equipment of the cane-grower's income-producing machine and, therefore, part of his capital'. The compensation paid was accordingly held (at 310E-F) to have been paid to the taxpayer 'for the loss of its income-producing machine and consequently, it was a receipt of a capital nature.'

[29] The *Glenboig* and *Illovo Sugar* cases were referred to and described as 'well-known cases' in *Taeuber and Corssen (Pty) Ltd v SIR* 1975 (3) SA 649 (A). In this case an agency contract provided that upon termination the principal would be entitled to require that for a period of two years after the termination the agent would not sell, or assist in the sale of, any products in competition with the products of the principal, in return for which the principal was to pay the agent in monthly instalments 60 per cent of the commission which the principal had paid the agent in respect of agency contracts executed during the last twelve months of the agreement.

[30] This court held that the amount paid under this provision was of a capital nature. Rumpff CJ said (at 662A-B) that there was no doubt that at the time of the cancellation of the agreement the taxpayer 'had established an income-producing structure. [This] structure . . . consisted not only of premises, personnel and the right to trade but also of certain specific contractual rights and duties, *inter alia,* those that flowed from the contract with [the principal].'

[31] Later (at 663H-664A) he said:
'What the parties intended . . . was a payment of a sum of money to restrain the

[taxpayer], for a period of two years, from earning income by the sale of all products competing with those of [the principal]. In the result, in my view, that part of [the taxpayer's] income-producing structure which had sold only [the principal's] products was not only permanently prevented from selling [the principal's] products by the termination of the agreement, but also effectively closed for two years to the extent that it was prevented, for that period, from selling all such products as would compete with [the principal's] products, and the amount payable in terms of [the relevant clause] was intended to be, and must be construed as, compensation for this closure.'

[32] The last decision to which I wish to refer in this regard is *ITC* 1338, 43 SATC 171, a judgment delivered by McEwan J in the Transvaal Special Court. In this case the taxpayer agreed with the company by which he was employed, in return for the payment of R30 000, to be bound by certain restraints, the most important of which prevented him for a period of two years after the termination of his employment form being employed by or concerned in any rival undertaking in the trade in which he had worked his whole working life. Clause 4 of the agreement provided, in effect, that in the event of a change in control of the company he could, upon repayment of the R30 000, obtain his release from the restraint. (I pause here to remark that the person or persons who drafted the 1992, 1996 and 1998 agreements apparently based clause 4.4 of the agreements signed by the appellant on clause 4 of the contract considered in *ITC* 1338.)

[33] At 174 after referring to the principles laid down, *inter alia,* in *Taeuber & Corssen, supra,* McEwan J said that there could 'be no doubt that the same principles apply in the case of an individual'. He continued:

'An employee who by means of a covenant in restraint of trade surrenders a portion of his income-earning capacity in return for a payment of money, is parting with a capital asset and the payment is of a capital nature.'

[34] He then referred with approval, *inter alia,* to *Beak v Robson and Higgs v Olivier.*

[35] In my opinion the decision of the court *a quo,* based as it was on the fact that the restraint to which the appellant agreed in the 1996 and 1998 agreements was identically worded to the restraint in the 1992 agreement, (which led the court to hold that the appellant had 'given up no additional resource in exchange for the further payments in 1996 and 1998') overlooks the fact that there *was* a further asset which the appellant gave up in exchange for the payments. That was his right in 1996 to obtain his release from the 1992 restraint on payment of R350 000 and his right in 1998 to obtain his release from the 1992 and 1996 restraints on payment of R1 600 000. In both cases on the undisputed evidence his worth as an individual unfettered by a restraint was substantially in excess of the release consideration. This is what, from a commercial point of view, induced his employer to pay him the further amounts.

[36] I cannot agree with the court's finding (in para 73 at 270G-H) that '(t)he terms and conditions of [the 1996 and 1998 agreements] have been shown to be without force or effect' and that they 'appear to be meaningless save to provide a vehicle which apparently justified payment of the two sums of money.'

[37] I have no doubt that if the appellant had left his employment in the Macmed group while the companies in it were still trading

and had wanted to work for a competitor his erstwhile employers would have been able to obtain an interdict against him unless the proviso in clauses 4.4 of the three agreements applied and he paid them R4 600 000. It would not have availed him (if the proviso applied) to tender R350 000 and to say that the other two agreements were meaningless.

[38] When this point was put to Mr *Marais,* he attempted to meet it by saying that to uphold this point would offend against the parol evidence rule. I do not think there is anything in that point. It is quite clear, when all the agreements are looked at against the background of the admissible evidence on the point, what the parties intended. Mr *Marais* also submitted that this was not the basis on which the appellant approached the court *a quo.* Apart from the fact that the notice of objection was wide enough to cover the point, it must be remembered that the case was fought in the court below on the basis that the appellant was seeking to show that the receiver's reason for seeking to tax the amounts was his assertion that they were amounts of remuneration disguised as payments for agreeing to a restraint of trade. Finally Mr *Marais* contended that the point was not covered by the notice of appeal. This is also not correct as the point in my view is covered by paragraph 4 of the notice of intention to appeal.

[39] In my view the appeal should succeed.

[40] the following order is made:

The appeal is upheld with costs, including those occasioned by the employment of two counsel.

The order of the court *a quo* is set aside and replaced with an order in the following terms:

'(a) The appeal is upheld

(b) The 1998 assessment and the portions of the 1996 assessment relating to the amounts of R350 000 and R1 250 000 are set aside and referred back to the Commissioner for reassessment on the basis that the amount of R350 000 which accrued to the taxpayer under the 1992 agreement, the amount of R1 250 000 which accrued to the taxpayer under the 1996 agreement and the amount of R3 000 000 which accrued to the taxpayer under the 1998 agreement did not fall within the taxpayer's gross income.'

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IG FARLAM

JUDGE OF APPEAL

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