THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

JUDGMENT

Case No: 441/09

In the matter between:

ACKERMANS LIMITED Appellant

and

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE Respondent

In the matter between

PEP STORES (SA) LIMITED Appellant

and

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE Respondent

Neutral citation: *Ackermans v CSARS* (441/09) [2010] ZASCA 131 (1 October 2010).

Coram: NAVSA, CLOETE, CACHALIA, MHLANTLA and BOSIELO JJA

Heard: **20 September 2010**

Delivered: **1 October 2010**

Summary: Income Tax Act 58 of 1962; meaning of 'expenditure' in s 11(a).

ORDER

On appeal from: South Gauteng Tax Court (Johannesburg) (Willis J presiding):

The appeals are dismissed, with costs, including the costs of two counsel.

JUDGMENT

CLOETE JA (NAVSA, CACHALIA, MHLANTLA and BOSIELO JJA concurring):

[1] There are two appeals before the court: one by Ackermans Ltd and one by Pep Stores (SA) Ltd. On 1 March 2004 Ackermans sold its retail business as a going concern to Pepkor Ltd. At issue in the appeal is whether by virtue of the sale agreement Ackermans is entitled to a deduction, in terms of s 11(a) of The Income Tax Act 58 of 1962, of the sum of R17 174 777 in respect of its 2004 year of assessment. Save for the specific nature and amount of the contingent liabilities on which the disputed deductions sought by Pep Stores were based, the facts of the Pep Stores appeal are identical to the Ackermans appeal. The outcome of the Ackermans appeal will accordingly determine the fate of the Pep Stores appeal. The South Gauteng Tax Court sitting in Johannesburg (presided over by Willis J) found against the appellants and confirmed the assessments of the Commissioner. The appellants' application for leave to appeal to this court in terms of s 86A of the Act was subsequently granted.

[2] In terms of the sale agreement Ackermans sold the 'business' to Pepkor as a going concern. The 'business' was defined as Ackermans' retail clothing business, including the 'business assets', the 'liabilities' and the 'contracts' as at the effective date (1 March 2004). The 'liabilities' were defined

as meaning 'all the liabilities arising in connection with the business, in respect of any period prior to the effective date, known to [Ackermans] as at the effective date'. The liabilities were in fact R329 440 402. They included three amounts, to which I shall for convenience refer as 'the three contingent liabilities', namely:

(a) R9 880 666, being a contingent liability in respect of Ackermans' contractual obligation to fund post-retirement medical aid benefits for its employees;

(b) R6 394 111, being a contingent liability in respect of Ackermans' obligations to employees under a long-term bonus scheme; and

(c) R900 000, being a contingent liability in respect of repair obligations undertaken by Ackermans under property leases.

It is these three contingent liabilities, which total R17 174 777, around which this appeal revolves.

[3] The 'purchase price' was defined as 'the amount equal to the sum of R800m and the rand amount of the liabilities' – ie R800m plus R329 440 402, totalling R1 129 440 402. The purchase price was to be discharged as follows:

(a) as consideration for inter-company and other loans owed to Ackermans, by an assumption by Pepkor of an equivalent amount of the 'accounts payable' ie amounts due by Ackermans to trade creditors as at and in respect of the period prior to 1 March 2004;

(b) as consideration for the remaining business assets sold,

(i) the assumption by Pepkor of the remainder of the liabilities and

(ii) the creation of an R800m loan account owed by Pepkor to Ackermans.

[4] In terms of the sale agreement therefore, Pepkor assumed all of Ackermans' liabilities, including the three contingent liabilities. The appellants' counsel submitted, and the submission is not contentious, that had Ackermans retained its business and continued to trade, the three contingent liabilities would have been deductable in its hands as and when they became unconditional because:

(a) salary and employee benefits paid by a taxpayer are incurred in the production of income and are of a revenue nature. Post-retirement medical aid subsidies and long-term bonuses are designed to attract and retain high quality staff and to incentivize them to render good service, all for the benefit of the business; and

(b) similarly, rental and related property expenditure (eg maintenance, repair and restoration) incurred by a taxpayer for the use of the premises from which it trades are revenue expenses incurred in the production of income.

[5] Ackermans does not claim an entitlement to deduct the three contingent liabilities. This would not have been competent since they were still conditional at the effective date when Pepkor assumed them. Rather, a deduction is claimed on the basis that under the sale agreement Ackermans incurred expenditure (in the sense envisaged in s 11(a) of the Act) in an amount equal to the contingent liabilities. The submission was that Ackermans did so by foregoing a portion of the asset purchase price (to which it would otherwise have been entitled) equal to the value of the contingent liabilities. The economic effect of the sale agreement in respect of Ackermans' liabilities, including the three contingent liabilities, it was contended, was that Ackermans received, for assets sold at R1 129 440 402, only R800m; and that the position is the same as if Ackermans had received R1 129 440 402 from Pepkor and paid R329 440 402 back to Pepkor for the latter to assume the liabilities as at the effective date. The appellants' counsel submitted, with reference to South African,[1] English[2] and Australian[3] authorities, that when lump sum expenditure is incurred by a taxpayer to free itself from anticipated or contingent revenue expenses, such expenditure is generally itself of a revenue nature, and that this applies to Ackermans' expenditure in the present case. It will not be necessary to consider the correctness of this submission.

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[1] *SIR v John Cullum Construction Co (Pty) Ltd* 1965 (4) SA 697 (A).

[2] *Hancock v General Reversionary & Investment Co Ltd* [1919] 1 KB 25; *Rowntree & Co Ltd v Curtis* [1925] 1 KB 328 (CA); *British Insulated & Helsby Cables Ltd v Atherton* [1926] AC 205 (HL); *Anglo-Persian Oil Co Ltd v Dale* [1932] 1 KB 124 (CA);*Heather v P-E Consulting Group Ltd* [1973] 1 All ER 8 (CA) and *Vodafone Cellular Ltd v G Shaw (HM's Inspector of Taxes)* [1997] EWCA Civ 1297.

[3] *Spotlight Stores (Pty) Ltd v CoT* [2004] FCA 650 and (on appeal) *Pridecraft Pty Ltd v CoT; CoT v Spotlight Stores Pty Ltd* [2004] FCAFC 339.

[6] It was contended on behalf of the Commissioner that the deduction claimed:

(a) did not constitute 'expenditure' or 'expenditure actually incurred';

(b) was not incurred in the production of income;

(c) was of a capital nature;

(d) was not incurred for the purposes of Ackermans' trade as required by s 23(g) of the Act;

(e) was precluded from deduction by operation of s 23(e) of the Act (which refers to 'income carried to any reserve fund or capitalised in any way'); and

(f) was precluded from deduction by operation of s 23(f) of the Act (which refers to 'expenses incurred in respect of any amounts received or accrued which do not constitute income as defined in section one').

It will be necessary to deal only with the first issue raised by the Commissioner.

[7] The Commissioner submitted that Ackermans did not have any obligation to make a payment to Pepkor in terms of the sale agreement, and that the manner in which the purchase price was discharged did not involve any expenditure being incurred by Ackermans. To this the appellant replied that deductable 'losses', as comprehended in the phrase in s 11(a) 'expenditure and losses actually incurred', can exist independently of a legal liability (eg where trade stock is destroyed in a fire or money is stolen from the business); and that being so, there is no reason why 'expenditure' must necessarily have its source in a legal liability owed by a taxpayer to a third party. The economic consequences of a transaction should thus be examined to ascertain whether it has resulted in an actual diminution of, or has had a prejudicial effect on, the taxpayer's patrimony. Therefore (I quote from counsel's heads of argument):

'Whether the contract created an actual liability on Ackermans' part to pay R329 440 402 to Pepkor (a liability which would be settled through set-off) is, we submit, irrelevant. From the perspective of Ackermans' patrimony, the commercial effect is precisely the same as if such a liability had been created.'

[8] I cannot accept this argument. To my mind, 'expenditure incurred' means the undertaking of an obligation to pay or (which amounts to the same thing) the actual incurring of a liability. No liability was incurred by Ackermans to Pepkor in terms of the sale agreement. The manner in which the purchase price was discharged by Pepkor did not result in the discharge of any obligation owed by Ackermans to Pepkor. Ackermans owed Pepkor nothing in terms of the sale agreement and one looks in vain for a clause in that agreement that has this effect. It is for this very reason that the appellant in its oral submissions abandoned any reliance on set-off, which would have been the inevitable effect if there had been these reciprocal obligations. At the outset, in the initial letter of objection to the assessment by SARS, written by auditors acting on behalf of the appellants, there was reliance on set-off in the following terms:

'13.8.1 The purchaser undertook to buy Ackermans' business for R1 129 440 402. The purchaser thus owed this amount to Ackermans.

13.8.2 Ackermans undertook to pay the purchaser R329 440 402 to take over its existing and future liabilities. Ackermans thus owed this amount to the purchaser.

13.8.3 It is the two aforementioned mutual but opposing debts which were set off against each other, namely the R1 129 440 402 owed to Ackermans by the purchaser, and the R329 440 402 owed to the purchaser by Ackermans, which underscores clause 6.1.2.[4]

13.8.4 In other words, in stead of the purchaser physically paying Ackermans R1 129 440 402, and Ackermans physically paying the purchaser R329 440 402, the parties allowed for set-off to operate, which meant that the amount of R329 440 402 was set-off against R1 120 440 402, resulting in a figure of R800 000 000 owed by the purchaser to Ackermans. There is nothing sinister about such a contractual arrangement, it occurs in overabundance in commercial life.

13.9 The payment of R23 017 959 so incurred by Ackermans on 1 March 2004 as part of the set-off arrangement was unconditional, as it was actually paid to the

[4] Clause 6.1.2 of the sale agreement, paraphrased in para 3 above, provides:
'6.1 The Purchase Price shall be discharged as follows by the Purchaser:
. . .
6.1.2 as consideration for the remaining Business Assets:
6.1.2.1 the Purchaser will assume the remainder of the Liabilities, and
6.1.2.2 the Purchaser will with effect from the Effective Date owe the Seller R800 000 000,00 (eight hundred million rand) as a loan and which will be reflected as a loan account in the books of the Seller.'

purchaser through set-off on the day (1 March 2004) that the obligation arose to pay this amount.'

The argument is untenable. It is trite that set-off comes into operation when two parties are mutually indebted to each other, and both debts are liquidated and fully due. That is not what happened here and the argument based on set-off was correctly abandoned.

[9] It was submitted on behalf of the respondent that unless the three contingent liabilities were allowed as a deduction in the hands of Ackermans, an anomaly would arise as they would never be deductible. The argument is without foundation. There would be no bar to Pepkor deducting the liabilities as and when they became unconditional, as counsel representing the Commissioner rightly conceded.

[10] It is clear that what occurred, as is usually the case in transactions of this nature, is that the nett asset value of the business ─ the assets less the liabilities ─ was calculated and that this valuation dictated the purchase price. In the ordinary course of purchasing the business as a going concern on this basis it would follow that the liabilities would be discharged by the purchaser. The journal entries relied on by the appellants do not equate to expenditure actually incurred. On the contrary, the mechanism employed in the agreement of sale resulting in the journal entries was to facilitate the sale.

[11] The fact that Ackermans rid itself of liabilities by accepting a lesser purchase price than it would have received had it retained the liabilities, does not mean in fact or in law that it incurred expenditure to the extent that the purchase price was reduced by the liabilities. At the effective date no expenditure was actually incurred by Ackermans.

[12] The appellants accordingly fail at the first hurdle. The appeals are dismissed, with costs, including the costs of two counsel.

T D CLOETE
JUDGE OF APPEAL

APPEARANCES:

APPELLANTS:	O L Rogers SC (with him M W Janisch)
	Instructed by Werksmans, Tyger Valley McIntyre & Van der Post, Bloemfontein
RESPONDENTS:	A Rafik Bhana SC (with him Ms J T Boltar)
	Instructed by The Registrar, Tax Court, Pretoria The Commissioner for The South African Revenue Service, Pretoria