



THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

Case No: 669/10

In the matter between:

**COMMISSIONER FOR THE SOUTH AFRICAN
REVENUE SERVICE**

Appellant

and

LABAT AFRICA LIMITED

Respondent

Neutral citation: *CSARS v Labat* (669/10) [2011] ZASCA 157 (28 September 2011)

Coram: Harms AP, Lewis, Heher and Maya JJA and Plasket AJA

Heard: 16 September 2011

Delivered: 28 September 2011

Summary: Income Tax Act 58 of 1962 – s 11(gA)(iii) – allowable deductions for the acquisition of intellectual property rights – meaning of ‘expenditure’ – shares issued as consideration not ‘expenditure’

O R D E R

On appeal from: North Gauteng High Court, Pretoria (sitting as a court of appeal):

1 The appeal is upheld with costs.

2 The order of the court below is set aside and replaced with an order upholding the Commissioner's appeal from the Income Tax Special Court with costs and replacing its order with one dismissing the taxpayer's appeal.

J U D G M E N T

HARMS AP (LEWIS, HEHER AND MAYA JJA AND PLASKET AJA concurring)

[1] The Income Tax Act 58 of 1962 provides for allowable general deductions for the determination of a taxpayer's taxable income. Section 11(gA), as it read during the relevant 2000 tax year, provided for the amortisation of the cost of the acquisition of intellectual property rights at the rate of 4 per cent per annum and read, as far as trade marks are concerned, as follows –

11. 'For the purpose of determining the taxable income derived by any person from carrying on any trade within the Republic, there shall be allowed as deductions from the income of such person so derived –

. . .

(3A)(iii) an allowance in respect of any expenditure . . . actually incurred by the taxpayer . . . in acquiring by assignment from any other person any . . . trade mark . . . if such . . . trade mark . . . is used by the taxpayer in the production of his income or income is derived by him therefrom . . .'

[2] The taxpayer, the present respondent (Labat Africa Ltd), acquired the trade mark 'Labat-Anderson' through assignment during the tax year and sought to claim the deductible allowance. The appellant, the Commissioner for the SA Revenue Service, disallowed the claim. The Income Tax Special Court, Pretoria, upheld the

taxpayer's appeal and the full court of the North Gauteng High Court subsequently dismissed the commissioner's appeal against the judgment of the special court. The appeal is before us with special leave of this court.

[3] The taxpayer, under its former name of Acrem Holdings Ltd, purchased 'the entire business operations' of Labat-Anderson (South Africa) (Pty) Ltd in terms of a written agreement dated 15 February 1999. Its effective date was 1 June 1999. The business operations of Labat-Anderson were defined to include all its tangible and intangible assets including, more particularly, the trade mark. In terms of clause 6 of the agreement, under the heading 'sale', the taxpayer 'purchased' the business 'for a consideration' of R120 million, 'discharged by the issue to Labat-Anderson' of 133 333 333 Acrem shares 'at an issue price of 90 cents per share'. (Although called a sale, the agreement was not a sale because a sale requires payment in money and not consideration in kind.) The clause further provided that the 'purchase price' was to be apportioned as to the net tangible assets at the values reflected in the accounts, then to the value of the trade mark and name in an amount as determined by an independent and suitably qualified valuator, and the balance was to be apportioned to goodwill.

[4] An increase and subdivision of the authorized share capital of the taxpayer was necessary in order to create these shares. The terms of the agreement were approved and the necessary special resolutions were taken to give effect to the transaction. The shares were issued and transferred in terms of the agreement and their value, at the time of transfer, was in excess of the issue price. The trade mark was valued at R44 462 000 and the allowance claimed was based on this valuation. Its correctness was not in dispute.

[5] The sole issue between the parties was whether, within the context and meaning of the statutory provision, 'any expenditure' had 'actually' been 'incurred' by the taxpayer. The special court found that the issuing of the shares with a value equal to the value of the trade mark meant that the taxpayer did actually incur expenditure in obtaining assignment of the trade mark (*ITC 1801 (68) SATC 57*). The court had two basic reasons for this conclusion.

[6] It said, firstly, that the expression 'expenditure actually incurred' means in the present context that the taxpayer must have incurred an unconditional legal obligation in respect of the amount concerned; it is not required that the obligation be discharged: once the obligation has been incurred, the expenditure becomes deductible. For this the court relied on *Edgars Stores Ltd v Commissioner of Inland Revenue* 1988 (3) SA 876 (A) at 888G-889C and 885A-B which, in turn, was based on *Nasionale Pers Bpk v Kommissaris van Binnelandse Inkomste* 1986 (3) SA 549 (A) at 564A-C.

[7] Although the court stated the principle to be deduced from these judgments correctly the problem is that they did not deal with the meaning of 'expenditure' but with the question when the expenditure was actually incurred (see eg *Edgars* at 891C-D). They held that it was incurred during the tax year in which the obligation arose. See also *Commissioner for Inland Revenue v Golden Dumps (Pty) Ltd* 1993 (4) SA 110 (A) where the same question arose (at 113C-D). It was never an issue in the instant case as to when liability arose. The transfer of the shares took place against the assignment of the trade mark and the taxpayer sought to claim the allowance in the year the obligation was incurred.

[8] The question the court should have posed was whether the issuing of shares by a company amounts to 'expenditure' and not whether the undertaking to issue shares amounts to an obligation, which it obviously does. The terms 'obligation' or 'liability' and 'expenditure' are not synonyms. This is apparent from what was said by Botha JA in *Caltex Oil (SA) Ltd v Secretary for Inland Revenue* 1975 (1) SA 665 (A) at 674D-E, namely that the expression 'any expenditure actually incurred' means 'all expenditure for which a liability has been incurred during the year, whether the liability has been discharged during that year or not'. (Emphasis added.)

In other words, the liability or obligation must be discharged by means of expenditure – timing is not the question.

[9] But the special court did seek to pose the correct question when it referred to some English judgments that dealt with the effect of a transaction in terms of which a company acquires assets 'in consideration' of the issue of fully-paid shares. The full court likewise asked whether the issue of a company's own authorized share capital in exchange for a trade mark 'represents real consideration given by the company'.

[10] The first judgment relied on was *Osborne v Steel Barrel Co Ltd* [1942] 1 All ER 634 (CA). It was an income tax case but the applicable statutory provision was not identified. There is at least no indication that the statute used the term 'expenditure'. The court decided that the issue of shares for the acquisition of assets amounted to 'consideration' given by the company. That is hardly contentious. The second issue the court had to decide was on what principle the value of the acquired assets had to be ascertained. It adopted the following approach: shares may not be issued at a discount; if a company accepts assets instead of money as consideration for shares the value of the assets must be at least the par value of the shares and must be based on an honest estimate by the directors of the value of the assets acquired. This, too, does not appear to be contentious but how it bears on the question whether the issue of shares amounts to 'expenditure' I do not understand.

[11] The next case was *Craddock v Zevo Financing Co Ltd* [1944] 1 All ER 566 (CA) which was followed by *Stanton (Inspector of Taxes) v Drayton Commercial Investment Co Ltd* [1982] 2 All ER 942 (HL). The latter dealt with the meaning of a provision in the Finance Act 1965 which allowed a deduction 'from the consideration' of the 'gain accruing to a person on the disposal of an asset' which had to be restricted to 'the amount or value of the consideration, in money or money's worth' given for the acquisition of the asset. Lord Fraser extracted two propositions from the *Craddock* decision: a company can issue its own shares 'as consideration for the acquisition of property' and, secondly, that the value of consideration given in the form of fully paid shares allotted by a company is not the value of the shares allotted but is, in the case of an honest and straightforward transaction, the price on which the parties agreed (at 946j-947a). He added that, absent dishonesty and the like, tax authorities are not entitled to go behind the agreed consideration (at 947j). Once more, it escapes me how these decisions have any bearing on the meaning of 'expenditure' as used in s 11 of the Act.

[12] The term 'expenditure' is not defined in the Act and since it is an ordinary English word and, unless context indicates otherwise, this meaning must be attributed to it. Its ordinary meaning refers to the action of spending funds; disbursement or consumption; and hence the amount of money spent. The Afrikaans text, in using the term 'onkoste', endorses this reading. In the context of the Act it

would also include the disbursement of other assets with a monetary value. Expenditure, accordingly, requires a diminution (even if only temporary) or at the very least movement of assets of the person who expends. This does not mean that the taxpayer will, at the end of the day, be poorer because the value of the counter-performance may be the same or even more than the value expended.

[13] At the relevant time the provisions of the Companies Act 61 of 1973 applied. Section 92(1) provided that:

'No company shall allot or issue any shares unless the full issue price of or other consideration for such shares has been paid to and received by the company.'

The allotment of shares in terms of clause 6 of the contract complied with this provision. It would otherwise have been void (*Bauermeister v C C Bauermeister (Pty) Ltd* 1981 (1) SA 274 (W)). I have already noted that the agreement was not one of sale. The taxpayer, however, argued otherwise and referred to the fact that a money value had been placed on the shares. The answer to the submission is to be found in *Lace Proprietary Mines Ltd v Commissioner for Inland Revenue* 1938 AD 267 at 280 where Stratford CJ pointed out that reference in a similar contract to the so-called sale price and nominal value of shares cannot override the true intention of the parties: that the true consideration was the shares and not the money simply because no cash consideration could have been demanded by the taxpayer from the 'seller'.

[14] Labat-Anderson assigned the trade mark as consideration for the shares and the taxpayer did not 'expend' any money or assets in acquiring the trade mark. As Goldblatt J said in *ITC 1783* (66) SATC 373, an allotment or issuing of shares does not in any way reduce the assets of the company although it may reduce the value of the shares held by its shareholders, and that it can therefore not qualify as an expenditure. It would have been more correct if he had said that it did not involve a shift of assets of the company even though it might, but not necessarily, dilute or reduce the value of the shares in the hands of the existing shareholders. If authority is needed for the self-evident statement of the learned judge that an allotment of shares does not diminish a company's assets, one may refer to *Commissioner for Inland Revenue v Estate Kohler & others* 1953 (2) SA 584 (A) at 593H and 600F which was followed by *Estate Furman & others v Commissioner for Inland Revenue* 1962 (3) SA 517 (A).

[15] The full court disagreed with Goldblatt J on two grounds. The first was based on its incorrect application of *Edgars Stores*. The other was a 'set-off' argument propounded on behalf of the taxpayer. How one can set off shares against money was not explained. In any event, the full court said that if the agreement had been that Labat-Anderson would have purchased the shares at an agreed price and that the proceeds of the sale would be applied to the purchase price, there could be no doubt that the transaction would constitute an expenditure by the company of its share capital, and that it is difficult to see the difference between this construction and the present agreement. Whether or not the premise of the full court is correct, the conclusion misses the point. Because there is no suggestion that the contract is in any way simulated we have to take it as we find it. The fact that the parties may have constructed their agreement differently and tax-efficiently is entirely beside the point.

[16] The author 'DM' was also very critical about the judgment of Goldblatt J in a note entitled 'Paying for Goods or Services by Issuing Shares' in *The Taxpayer* 2004 (May) 86. The author said that it was disconcerting that the learned judge did not refer to 'a body of law' in the United Kingdom dealing with the expenditure involved when a company pays for assets or services by the issue of shares. Apart from the fact that DM implied that such a contract is one of sale, the body of law referred to by the author nowhere deals with the meaning of the term 'expenditure'. As indicated, it dealt with entirely different issues. DM's second criticism was that Goldblatt J did not refer to the Companies Act which required that a company must obtain a quid pro quo in cash or other valuable consideration not less than the nominal value of the shares to be issued. As intimated above, these provisions are of no assistance in interpreting s 11.

[17] The taxpayer submitted that serious anomalies would arise if the allotment of shares is not regarded as expenditure. The first response could be that tax laws notoriously contain many anomalies and inconsistencies. The first inconsistency relied on is that the receipt of shares as consideration for the 'sale' of an asset 'is consideration in the hands of the seller for purposes of determining the seller's tax liability'. It would, said counsel, be incongruous to regard those shares as being 'consideration' in the hands of the seller but not as being consideration in the hands

of the 'purchaser' for the same purposes. The problem, if there is one, is the result of the fact that 'gross income' is defined (as far as is relevant) as the total amount, 'in cash or otherwise', received by or accrued to or in favour of a local taxpayer but excluding accruals of a capital nature. We first have to assume that the accrual of the shares was not of a capital nature. If it was not, one moves to the definition of 'income' which is defined to mean the amount remaining of the gross income after deducting therefrom any amounts exempt from normal tax under a number of provisions, including s 11. The taxable income is not the difference between gross income and expenditure; and gross income is not limited to the converse of expenditures. Expenditure, to be deductible, must not be of a capital nature – and a trade mark is a capital asset. It is only because of the special dispensation that amortisation of the cost of acquisition of this capital asset is permitted. The equation (if there is one) is therefore much more complicated than suggested by counsel.

[18] The other anomaly relied on has to do with the introduction of capital gains tax, something that happened after the tax year under consideration. It is not possible to interpret the Act as it stood in the year 2000 with reference to later amendments. If the amendment created an anomaly ex post facto, it is a matter for Parliament to attend to (Mr Marais for the Commissioner said it has already done so).

[19] In the result the following order issues:

- 1 The appeal is upheld with costs.
- 2 The order of the court below is set aside and replaced with an order upholding the Commissioner's appeal from the Income Tax Special Court with costs and replacing its order with one dismissing the taxpayer's appeal.

L T C Harms
Acting President

APPEARANCES:

For Appellant:

P J J Marais SC

Instructed by:

The State Attorney, Pretoria

The State Attorney, Bloemfontein

For Respondent:

A Rafik Bhana SC (with him J Boltar)

Instructed by:

Van der Merwe Attorneys, Pretoria

Kramer Weihmann Joubert Inc,

Bloemfontein