CASE NO. 51/95

IN THE SUPREME COURT OF SOUTH AFRICA

(APPELLATE DIVISION)

In the matter between:

RAND MINES (MINING & SERVICES) LTD Appellant

and

COMMISSIONER FOR INLAND REVENUE Respondent

CORAM: Corbett CJ, Hefer, Nienaber, Marais et Zulman JJA HEARD: 26 August 1996

DELIVERED: 27 September 1996

J U D G M E N T

MARAIS JA/

MARAIS JA:

This is an appeal against a decision of the Cape Income Tax Special Court. The issue and the circumstances which gave rise to it were summarised thus by the Special Court:

"The appellant is a mine management company and a member of a large group of mining companies. Its principal function, broadly speaking, is the administration and management of the mines controlled by the group. In determining its liability for normal tax for the year of assessment ended 30 September, 1988, the Commissioner for Inland Revenue ('the Commissioner') disallowed as a deduction an amount of R30-million. The appellant's objection to this disallowance was overruled and hence the appeal to this Court. The sum of R30-million, described in the appellant's Income Tax Schedule as expenditure for 'management and services rights', represents the amount paid by the appellant in the circumstances detailed below for a contract to manage a mine which had come under the control of the group. The question to be decided is whether the sum of R30-million is deductible in terms of section 11 (a) of the Income Tax Act 58 of

1962, as amended. That section, for the purpose of determining the taxable income of any person from carrying on a trade within the Republic, allows as deductions from income 'expenditure and losses actually incurred in the Republic in the production of the income, provided such expenditure and losses are not of a capital nature*. It is common cause that the expenditure in the present case was incurred in the Republic of South Africa during the year of assessment and in the production of income. The issue is whether or not the expenditure was of a capital nature.

As previously mentioned, the business of the appellant is the administration and management of a large number of mines. While each mine owning company has its own employees, the appellant provides a management service, including technical supervision, as well as legal, accounting and other such services. It has, or had at the relevant time, two divisions, a coal division and a gold, platinum and uranium division. It operates from central Johannesburg and employs a large staff. Indeed, its salary and employment expenses for the year under discussion amounted to over R37-million. According to its balance sheet for that year it had fixed assets having a value of some

R36-million comprising mineral rights, equipment, aircraft, vehicles and furniture. The mines which the appellant manages are largely those which are controlled by the group of companies to which the appellant belongs but, as explained by Mr Bradshaw, a director who gave evidence, the appellant is prepared to deal with any mining company that requires its services and has in the past, as Mr Bradshaw put it, 'been .... across the world looking for management contracts and for mines to administer'.

The management and other services in question are provided by the appellant in terms of a contract which it concludes in each case with the mine owning company. This contract, which has standard terms, makes provision for the payment to the appellant of an administration fee calculated on a specified percentage of working capital as well as a capital expenditure fee, a marketing and selling fee, a buying fee and a service fee, all of which are percentage based. The contract is generally for a fixed period of 5 years and thereafter for an indefinite period until terminated by either party giving 5 years written notice; in other words, a minimum period of 10 years.

Upon its formation, or shortly thereafter, the appellant concluded contracts with all the mine owning companies within the group which then numbered 28. From 1983 to the end of the year of assessment ended 30 September, 1988 the appellant continued to manage the mines controlled by the group. During this period the number of mines in question increased to over 40. The contracts were all concluded without the appellant having to pay a consideration therefor. As explained by Mr Bradshaw, the group required the appellant to manage all its mines. It would ordinarily not invest in a mine unless it could be managed by the appellant.

Against this background, I turn to the circumstances in which the appellant came to expend the amount which the Commissioner disallowed as an expense. In December, 1986, a company, to which I shall refer as 'Lefko' and which was not a member of the group, was incorporated in order to establish a platinum mine near Brits in the Transvaal. Lefko immediately entered into a management agreement with another company to which I shall refer as 'GD'. The agreement was for a period of 15 years with effect from the date of Lefko's incorporation, but with GD having the option to renew the contract for

a further 15 years. A certain Mr P, who was the director and beneficial holder of the entire issued share capital of GD, held the controlling interest in Lefko. In July, 1987, Lefko issued a prospectus with the object of raising funds in order to bring its platinum mine to production. The scheme ran into serious financial difficulties and in September, 1988, Lefko still needed an amount running into many millions of rands to complete the first phase of its mining project. At the time the price of platinum was comparatively high and a company in the group to which the appellant belonged and to which I shall refer as 'B Investments', entered into negotiations with a view to acquiring a controlling interest in Lefko. These negotiations resulted ultimately in the conclusion of three agreements on 23 September, 1988. In terms of what was called the main agreement, B Investments acquired by way of a purchase and exchange of shares, the controlling interest in Lefko. This agreement was conditional upon the cancellation of the existing Lefko management agreement with GD and the conclusion of a new management agreement between Lefko and the appellant. The cancellation of the existing management agreement was effected by the parties involved, including the appellant and GD, entering into a 'management termination agreement', being one of the agreements

concluded on 23 September, 1988. In terms of this agreement the existing management agreement was cancelled and in return the appellant paid GD the sum of R30-million. It is this payment, of course, which is the subject matter of the present appeal. The new management agreement was concluded between the appellant and Lefko and took the form of the appellant's standard management agreement. It made provision, however, for either party to give the other 5 years written notice, but which notice was not to be given until the lapse of 15 years. In other words, the contract was to endure for a period of not less than 20 years. It is also necessary to mention that the amount invested by B Investments to acquire the controlling interest in Lefko was considerable and exceeded R300-million. At a relatively early stage in the negotiations, however, it was made clear by the shareholders of Lefko that the amount in question would not include the value of the management agreement with GD which would have to be negotiated separately with that company.

Subsequently, the platinum price dropped and the group elected to relinquish its controlling interest in three platinum mines, one of which was the Lefko mine. As a consequence, the appellant was obliged to

terminate its management of those mines. Accordingly, on 5 August, 1991, the appellant entered into an agreement in terms of which it ceded its rights and delegated its obligations under the management agreement it had concluded with Lefko on 23 September, 1988, as well as under the two other management agreements. In return it was paid the sum of R5-million. By this time, however, the appellant had received fees amounting to approximately R30-million under the Lefko management agreement.

In his evidence, Mr Bradshaw pointed out that prior to the formation of the appellant in 1983 the group had from time to time acquired various mines and subsequently disposed of them. The group had for example acquired at various stages platinum, chrome and asbestos mines which had subsequently been disposed of together, in each case, with the appropriate management agreement. Mr Bradshaw stressed, however, that it was not the business of the appellant to 'buy' and 'sell' management agreements. Indeed, the transaction in terms of which the appellant had acquired the Lefko management agreement was the first occasion on which it had 'bought' a management agreement in the sense of paying money in order to conclude such a contract or acquire

the rights thereunder. Subsequently in 1989, however, the appellant paid the sum of R7-million in return for the cession to it of the rights under a management agreement relating to a titaniferous magnetite mine. In 1991, and in addition to the receipt of R5-million for relinquishing its rights under the three platinum mine management contracts referred to above, the appellant was paid a further R5-million upon ceding its rights under a further 3 mine management contracts relating to chrome mines. As in the case of the platinum mines, the reason for the appellant ceding its rights under these contracts was the group relinquishing its controlling interest in the mines in question. It is not in dispute that all the receipts and expenditures arising from the acquisition and alienation of management agreements were treated as being of a revenue nature in the appellant's financial statements. No income tax assessments, however, have been issued to the appellant since 1988. Finally it is necessary to mention that in October, 1992, and in consequence of a restructuring within the group, the appellant's management agreements in respect of the group's gold mines were cancelled and in effect taken over by another company within the group. By the time of the hearing, the appellant retained only 6 of the original 28 contracts it had entered into in 1983."

The Special Court concluded that the expenditure in question was of a capital nature and accordingly not deductible in terms of section 11 (a) of the Income Tax Act 58 of 1962 ("the Act"). It is that finding which is under attack in this appeal. Before the validity of the attack is considered it is necessary to deal shortly with a preliminary question which arose.

At the hearing before the Special Court appellant was granted leave to amend its existing objection by adding a further ground in support of its objection to respondent's refusal to allow the deduction. The hearing proceeded thereafter on the basis that only the original ground of objection would be considered by the Special Court and, if that was not upheld, that the further hearing of the appeal would be postponed sine die with a view to the additional ground of objection being considered at some convenient future date. In the

result, the Special Court did not uphold the originally raised ground of objection, and concluded its judgment with these words:

> "It was agreed between the parties that in the event of this Court dismissing the appeal with regard to the original ground of objection, the appeal with regard to the new alternative ground was to be postponed sine die and to be heard, if the same Court cannot be constituted, by another court constituted for this purpose. It is so ordered."

Notice of intention to appeal to this Court was given thereafter and the President of the Special Court (Scott J) granted such leave in terms of sec 86 A (5) of the Act. Appellant duly noted an appeal and proceeded to prosecute it. Shortly before the hearing of the appeal this Court intimated to the parties' legal representatives that it wished to hear argument as to whether or not an appeal is maintainable at this stage having regard to the nature of the decision given and the ensuing order made by the Special Court. Counsel

presented argument on the question and were granted leave to supplement their submissions later if so advised. Argument on the merits of the Special Court's decision proceeded and judgment was reserved on both issues. The Court has now been formally advised that appellant abandons the additional ground of objection. The consequence is that the question which arose, namely, whether this Court has jurisdiction to hear an appeal against a decision in what amounted to a matter which was only part heard in the Special Court, has fallen away. The Special Court's order postponing the further hearing of the matter sine die has become inoperative and its decision "dismissing the appeal with regard to the original ground of objection" may now properly be regarded as a decision dismissing the appeal as a whole, thus clearing the way for this Court to exercise jurisdiction on appeal to it. It is therefore unnecessary to decide what the position

would have been if the further ground of appeal had not been abandoned. It is also unnecessary to decide whether or not it was competent for the Special Court to make provision for the hearing by a differently composed Special Court of what would have been no more than an additional ground to support the same objection of which the originally composed Special Court was seized, thus conceivably resulting in two differently composed Special Courts participating in the adjudication of one and the same objection against an assessment. 1 turn to the merits of the appeal. Yet again this Court is required to label expenditure incurred by a taxpayer as either capital or revenue expenditure. The distinction is clear enough conceptually and by now so familiar that repetition is unnecessary. It will suffice to refer to the exposition of it in authoritative cases such as C1R v George Forest Timber Co Ltd 1924 AD 516; New State Areas Ltd

v CIR 1946 AD 610; Sub-Nigel Ltd v CIR 1948 (4) SA 580 (A); C1R v African Oxygen Ltd 1963 (1) SA 681 (A); SIR v Cadac Engineering Works (Pty) Ltd 1965 (2) SA 511 (A); SIR v John Cullum Construction Company (Pty) Ltd 1965 (4) SA 697 (A); Heron Investments (Pty) Ltd v SIR 1971 (4) SA 201 (A); Palabora Mining Co Ltd v SIR 1973 (3) SA 819 (A); Stone v SIR 1974 (3) SA 584 (A); and Dorstlap v SBI 1981 (4) SA 836 (A).

An abiding problem has been to identify and then synthesisc into a reasonably accurate and universally applicable yardstick the factors which are indicative of each of the two classes of expenditure. No such yardstick has yet been fashioned and the attempt has come to be regarded as futile and has been abandoned. Instead the courts have identified useful indicia to which regard may be had, emphasising that they are no more than that and that in each case

close attention must be given to its particular facts. In Commissioner of Taxes v Nchanga Consolidated Copper Mines Ltd [1964] 1 All ER 208 (PC) at 212, [1964] AC 948 at 959 Lord Radcliffe warned against the notion that any of the indicia identified by the courts, taken singly, will always lead to the right conclusion. He said:

> "..........all these phrases, as, for instance, 'enduring benefit' or 'capital structure' are essentially descriptive rather than definitive, and, as each new case arises for adjudication and it is sought to reason by analogy from its facts to those of one previously decided, a court's primary duty is to enquire how far a description that was both relevant and significant in one set of circumstances is either significant or relevant in those which arc presently before it."

Nonetheless, courts continue to be regaled with comparisons. Given the absence of a satisfactory litmus test of principle, it is inevitable that casuistic comparisons will be made and they undoubtedly have some value. Greater precision is regrettably simply not attainable

when value judgments such as this have to be made.

I commence by itemising the respects in which this expenditure differs from expenditure which would be regarded ordinarily as revenue expenditure. First, management contracts are not appellant's stock-in-trade in the sense that it acquires such contracts with a view to disposing of them at a profit. Appellant is not a jobber in management contracts. Cf ITC 998, 25 SATC 179 at 181 ("The appellant's business is that of a dealer in produce; in order to make a profit it has to buy and sell produce, in his case peas; it is not a dealer in contracts as such."); 1TC 1402, 47 SATC 221 at 225 ("Die appellant is nie 'n handelaar in kontrakte nie."); John Smith and Son v Moore 12 TC 266 at 296 ("The business carried on was not that of buying and selling contracts, but of buying and selling coals."). There can therefore be no suggestion that the money expended by

appellant in order to acquire the management contract is comparable

with the price which a merchant pays for a particular item of his

stock-in-trade and is therefore revenue expenditure. In HJ Rorke Ltd

v CIR 39 TC 194 Cross J said at page 205:

> "The cases .... undoubtedly draw a distinction between
> payments made to acquire stock-in-trade and payments made to acquire rights which will
> enable you to get stock-in-trade for
> yourself."

Appellant's stock-in-trade is the management services which it provides. The acquisition of the management contract merely obliged Lefko to allow appellant to render to it its management services. In other words, the expenditure resulted in the creation of a particular income earning opportunity for appellant which it otherwise would not have had.

Secondly, the expenditure was not incurred solely to

enable appellant to acquire the management contract. Nor was it expenditure undertaken at appellant's initiative. It was expenditure undertaken at its parent company's behest to facilitate the acquisition by the group of a controlling interest in Lefko. Unless GD was compensated, it would not have agreed to the cancellation of its management contract with Lefko. Unless the group had been able to appoint appellant to manage Lefko's mine, it would not have acquired the controlling interest in Lefko. Instead of the company in the group which acquired Lefko compensating GD and then appointing appellant to manage Lefko, appellant was required to compensate GD. However, the respective transactions were expressly stated to be interdependent and it was not contended that appellant had blithely bound itself to pay GD the sum of R30 million for the cancellation of its management contract with Lefko with no more in prospect than a

spes of being appointed manager of Lefko in its stead. Counsel for appellant acknowledged that GD was "bought off" for the benefit of both appellant and the company in the group which acquired control of Lefko. The symbiotic relationship between the transactions and the relationship between appellant and the companies in the group are such that it is tempting to say that, because the essential character of the transactions when viewed globularly in the context of the group is so plainly of a capital nature, it must follow that expenditure inextricably connected with them is also of that nature. However, 1 shall resist the temptation and content myself with observing that appellant had a dual purpose in mind when embarking upon this expenditure and that it was not simply a case of appellant buying on its own initiative, and solely in its own interests, a management contract from a third party as a normal incident of its income

producing activities.

Thirdly, clause 19 of the new management agreement precluded appellant from transferring its rights or delegating its obligations without the consent of Lefko to anyone other than another subsidiary of its parent company. This illustrates both the control which the parent company exercised over appellant's acquisition and disposal of management contracts and the extent to which appellant was beholden to the group in the matter of management contracts. As has been seen, the acquisition by appellant of management contracts was in practice inseparably connected with the acquisition or commencement of mines by the group.

Fourthly, the expenditure was made in order to acquire an asset intended to provide an enduring benefit for appellant. The contract was to endure for at least 20 years. There is also the sheer

size of the expenditure (R30 million) and its relative uniqueness (never before and on only one other occasion since has appellant paid to acquire a management contract). Cumulatively regarded, these factors give the expenditure the colour of a capital outlay.

Fifthly, when one asks whether the expenditure was to acquire something which added to the income earning structure of the business as opposed to expenditure routinely occurring in the running of appellant's business, the answer which commends itself to one as being correct is that it was to acquire an asset which added to the income earning structure of the business. Without such contracts, appellant would have no opportunity of doing that which generates its income, namely, managing mines. The contracts in themselves generate no income but they do provide appellant with the opportunity of generating income by providing the management services for which

payment will be made. They are assets of a capital nature which constitute part of the income earning structure of the appellant. In my view, they are comparable in principle with franchise agreements the cost of acquisition of which is not regarded as revenue expenditure. See ITC 1063, 27 SATC 57 in which it was held that a payment to a manufacturer of gramophone records for a sole right of distribution for 3 years with a right of renewal for 2 years was expenditure of a capital nature.

I turn to consider the contentions advanced by appellant in support of the characterization of the expenditure as revenue expenditure. It was submitted that the acquisition and disposal of management contracts was a normal and recurring incident of appellant's business and relevant statistical information was provided in support of the proposition. The impact of that is much diminished,

if not entirely dissipated, by the following considerations. The acquisition and disposal of management contracts does not occur at the instance of appellant but at the instance of its parent company. Appellant does not function autonomously in that respect. The acquisitions and disposals are always symbiotically linked to, and coincide with, acquisitions and disposals by the group of interests in mines. Any volatility that there may be in the acquisition, termination, or disposal of management contracts is therefore solely attributable to the group's acquisition and disposal of interests in mines. Moreover, appellant does not ordinarily pay to acquire a management contract. It was only necessary for it to do so in this particular instance because GD required to be compensated for the premature termination of its management contract with Lefko before it would release Lefko from that contract and so clear the way for Lefko to award the contract to

appellant. It was thus a most unusual item of expenditure and not a normal incident of appellant's business.

It was contended next that the ostensibly long duration of the contract should not be given significant weight because in practice such contracts were often prematurely terminated. It is so that management contracts were often prematurely terminated but that occurred, as I have explained, in the context of the group's policy of requiring appellant to surrender its right to manage mines in which the group no longer had an interest and to undertake the management of any mine in which it might acquire an interest. Thus, a prematurely terminated contract was likely to be replaced by another ere long.

It was conceded that so large an item of expenditure for an intangible asset such as a management contract might appear at first blush to represent capital expenditure but it was submitted that in the

light of the very large income which accrued to appellant as a consequence of acquiring the contract and performing the management services, the sum of R30 million paid by appellant was understandably large. That may be so but the fact remains that appellant ordinarily paid nothing for the management contracts which it acquired and this payment represented an unusual exception and a very large one at that. It was rightly said that indications such as these arc merely pointers in one or other direction and that none of them is decisive. It was contended that one of the most important indicia is the answer to the question whether the expenditure is more closely related to the cost of adding to or enhancing the income earning structure of appellant's business than to the cost of performing its income earning operations. See the Nchanga Consolidated Copper Mines case, supra, at 212 H - 213 B of the All England Law Reports.

An affirmative answer would point to the expenditure being expenditure of a capital rather than a revenue nature. A negative answer would point to the opposite conclusion. I think that the expenditure of the R30 million cannot be said to have been a cost incurred in the actual performance of appellant's income earning operations; it was a cost incurred in acquiring the right to perform those operations in this particular instance. The contract was "a source of profit" and the R30 million was spent to acquire it. See the African Oxygen case, supra, at 688 C. As Innes CJ observed in the George Forest Timber case, supra, at 526:

> "There is a great difference between money spent in creating or acquiring a source of profit, and money spent in working it. The one is capital expenditure, the other is not."

It is true, as counsel for appellant submitted, that appellant had an organizational structure in place which existed to enable it to generate

income by providing management services in terms of management contracts as they came and went, and that that structure remained relatively unaffected by the acquisition or loss of any particular management contract. But non constat that the management contracts did not also form part of the income earning structure of appellant's business while they were in place.

We were referred to a number of cases in which it was held that lump sums received by taxpayers as compensation for the premature termination of contracts which would have enabled them to earn future profits should be classified as revenue and not capital receipts. That was because they were surrogates for those profits. However, their classification as revenue receipts in the hands of the recipient does not mean that the corresponding payments must be classified as revenue payments by the party making them. Counsel for

appellant quite rightly disavowed any intention of contending the contrary. See Meyerowitz on Income Tax 1995-1996, paragraph 11.51. Whether such payments are to be regarded as capital or revenue expenditure when assessing their deductibility by the payer requires independent assessment.

We were also invited to find that the case of a landlord whose expenses in connection with leases would be deductible is comparable in principle with the present case. The invitation must be declined. A landlord's capital asset is his building. He puts it to work to generate income by hiring out the right to occupy it in return for rent. In entering into a contract of lease he is deploying his income earning asset to generate income. Expenses incurred in the preparation of a lease to record the transaction are expenses incurred in so deploying the income earning asset. The expense is not incurred to

acquire the right to deploy the asset to earn income. The landlord was always free to do so. Aliter in the present case where appellant had first to pay to acquire the right to provide Lefko with management services before it would be able to deploy its organizational structure to earn management fees from Lefko. It is akin to expenditure incurred in the acquisition of a licence which it is neccsary to have in order to carry out a particular income producing activity. In Pyrah v Annis & Co Ltd [1956] 2 All ER 858 (Ch); 37 TC 163, it was held that the costs of an unsuccessful application to vary an existing public carrier's licence by increasing the number of vehicles which could be operated from 4 to 7 was capital expenditure. See too ITC 198, 5 SATC 386; ITC 1224, 37 SATC 30. Appellant's contention entails comparing like with unlike. A truer but still not entirely valid comparison would be between the present case and a

case where a landlord purchases from another landlord the latter's leases, not with a view to their resale, but with a view to acquiring the rents payable under them. In such a case the purchasing landlord's outlay in acquiring the leases would surely not be regarded as expenditure of a revenue nature. Cf Turnbull v CIR 1953 (2) SA 573 (A) at 579 BE.

Counsel for appellant submitted that support for the proposition that the expenditure in this case was revenue expenditure is to be found in the decision of the Australian High Court in Federal Commissioner of Taxation v Maddalena 71 ATC 4161. The taxpayer was an employee electrician and a professional footballer. He claimed as a deduction travel and legal expenses incurred in seeking and obtaining a contract with a new and different rugby league club. The claim was disallowed. The passage in one of the judgments

in the case upon which appellant relies, reads:

> "Does then the expenditure in question fall within the description of an outgoing 'incurred in gaining or producing' his assessable income, or was it an outgoing 'necessarily incurred in carrying on a business'? I think not.
>
> It is, I think, worthwhile looking at the taxpayer's earnings as an electrician to illustrate what I regard as the decisive difference to be observed here. Had the taxpayer claimed as a deduction the expenses of changing from one job to another as an employee electrician his outlay would not have been an allowable deduction. The expenditure would have been incurred in getting, not in doing, work as an employee. It would come at a point too soon to be properly regarded as incurred in gaining assessable income. Nor would the expenditure have been an outgoing in carrying on a business. There is a difference of first importance for present purposes between an electrician who seeks work as an employee and an electrician who seeks contracts to do work as a principal. In the former case the electrician would not have a business; in the latter he would. In the latter, therefore, what he spent to obtain contracts to do electrical work would be properly regarded as an outgoing of his business. There is, however, a clear distinction between the two cases." (At 4163.)

The question which the court was considering and which it answered

adversely to the taxpayer was not whether the expenditure claimed as a deduction was capital or revenue expenditure, but whether it was expenditure incurred "in gaining or producing" his assessable income or in "carrying on a business". It is in that context that these remarks were made and I do not think they are of assistance in deciding the question which is before us.

All things considered, I am of the view that the Special Income Tax Court was right in its conclusion that the expenditure was of a capital nature and therefore not deductible. The appeal is dismissed with costs including the costs of two counsel. There is substituted for the order of the Court a quo an order dismissing the appeal and confirming the assessment.

Corbett CJ)
Nienaber JA) CONCUR
Zulman JA)

R M MARAIS