



**THE SUPREME COURT OF APPEAL OF SOUTH AFRICA**  
**JUDGMENT**

Case no: 131/2011

In the matter between:

**COMMISSIONER FOR SOUTH AFRICAN  
REVENUE SERVICE**

**Appellant**

and

**SOUTH AFRICAN CUSTODIAL SERVICES (PTY) LTD**

**Respondent**

**Neutral citation:** *Commissioner, South African Revenue Services v South African Custodial Services (Pty) Ltd* (131/11) [2011] ZASCA 233 (30 November 2011)

**Coram:** Brand, Maya, Cachalia and Mhlantla JJA and Plasket AJA

**Heard:** 7 November 2011

**Delivered:** 30 November 2011

**Summary:** Income Tax Act 58 of 1962 – s 79A – finality of assessment – whether letter from Commissioner a revised assessment – s 22(2A) – deductibility of cost of building prison in terms of concession agreement on land owned by State – sub-contractor, not respondent incurring expenses concerning materials and equipment – cost of building prison not deductible in terms of s 11(a) – s 11(bA) – interest and related fees deductible.

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ORDER

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On appeal from: the Tax Court, Pretoria (RD Claasen J sitting as court of appeal in terms of s 83 of the Income Tax Act 58 of 1962):

1 The appeal is upheld in part.

2 The respondent is directed to pay the costs of the appellant, including the costs of two counsel.

3 The order of the court below is set aside and replaced with the following:

'The assessment is referred back to the Commissioner for him to determine the amount that is deductible from the appellant's income in terms of s 11(bA) of the Income Tax Act 58 of 1962.'

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JUDGMENT

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PLASKET AJA (BRAND, MAYA, CACHALIA AND MHLANTLA JJA concurring)

[1] In terms of s 103(1) of the Correctional Services Act 111 of 1998, the Minister of Correctional Services may 'enter into a contract with any party to design, construct, finance and operate any prison or part of a prison'. On 3 August 2000, the respondent, South African Custodial Services (Louis Trichardt) (Pty) Ltd (SACS) and the Minister concluded a concession contract in terms of which SACS would design, construct and operate a prison in Louis Trichardt. The duration of the concession is 25 years. This appeal from the Tax Court, Pretoria (RD Claasen J) concerns three issues: the validity of SACS's objection to the assessment for the 2002 year of assessment, the deductibility of the cost of constructing and equipping the prison and the deductibility of interest and other costs.

[2] SACS appealed to the court below in terms of s 83 of the Income Tax Act 58 of 1962 (the Act) against the disallowance by the Commissioner for the South African Revenue Service, the present appellant, (the Commissioner) of its objection to the assessments of its tax liability for the 2002, 2003 and 2004 years of assessment. That appeal was successful, the court below finding that the

assessment for the 2002 year of assessment had not become final in terms of s 79A of the Act, as had been argued by the Commissioner, and that all of the expenditure in issue was deductible.

[3] In allowing the appeal, the court below made the following order (by a majority):

- '1. The prison constitutes appellant's trading stock in terms of section 22(2A) of the Act.
2. The whole amount of R511 196 332.00 is to be treated as trading stock and thus deductible.
3. The section 11(e) depreciation granted to the appellant in its 2002 year of assessment must be reversed as it would give rise to double accounting.
4. All the financial fees and expense and the legal fees are fully deductible.'

The court below granted leave to appeal to this court in terms of s 86A of the Act.

#### The facts

[4] SACS is a joint venture between a South African company, Kensani Consortium (Pty) Ltd, and the GEO Group, an American entity that specialises in the operation of correctional, detention and health facilities throughout the world. The concession contract that SACS concluded with the Minister is a public private partnership – a PPP – for purposes of the Treasury Regulations.

[5] The preamble of the concession contract states that the object of the contract is to give effect to the Department's wish to 'provide the public with cost-efficient, effective prison services, and to provide prisoners with proper care, treatment, rehabilitation and reformation in accordance with the provisions of the Correctional Services Acts, No. 8 of 1959 and No. 111 of 1998'.

[6] To this end, the concession contract provides that SACS would design and construct the prison and a road<sup>1</sup> on land provided by the Department.<sup>2</sup> SACS would have the right to occupy the land for the duration of the concession but would have 'no title to, or ownership interest in, or liens, or leasehold rights or any

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<sup>1</sup>Clause 13.1.

<sup>2</sup>Clause 11.1.

other rights in the land' and the State would 'at all times remain the owner of the land'.<sup>3</sup> Clause 11.6 provides:

'At the end of the Contract Term or at such earlier time as may be provided herein, the Contractor shall hand over the Site to the Department free of charges, liens, claims or encumbrances whatsoever, and free of liabilities, except for those in respect of which the Department has given its written approval.'

[7] Clause 7 deals with sub-contracting. Clause 7.1 provides:

'The Contractor shall not at any time permit any of its obligations under the Contract to be performed or undertaken by any parties (other than the Operating Sub-contractor or the Construction Sub-contractor except where the primary responsibility for the obligations which are sub-contracted remains with the Operating Sub-contractors or the Construction Sub-contractor (as the case may be) in terms of the Sub-Contracts and where any such sub-contractors have entered into binding contractual arrangements which enable the Contractor to perform all its obligations to the Department under this Contract) without the prior written consent of the Department, which consent shall not be unreasonably withheld or delayed.'

Clause 7.3 provides that SACS is 'directly responsible for the management and supervision of approved Sub-contractors'.

[8] SACS entered into a sub-contract (the construction contract) with CGM (Louis Trichardt) Joint Venture (CGM) in terms of which the latter was appointed to 'undertake the design, construction and commissioning of the prison at Louis Trichardt in accordance with the provisions of this contract'.<sup>4</sup> CGM was required, in terms of clause 2.6, to 'design, construct and commission the prison in discharge of part of [SACS's] obligation for the design, construction and commissioning of the prison in accordance with the terms and subject to the conditions in this contract'. In terms of clause 3.1 of the construction contract all the terms and conditions of the concession contract 'applicable to the design, construction, installation and commissioning of the prison are incorporated into and form part of' the construction contract.

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<sup>3</sup>Clause 11.2.

<sup>4</sup>Clause 2.5.

[9] Clause 48 of the construction contract defines the relationship between SACS and CGM as follows (to the extent relevant for present purposes):

'The Construction Sub-Contractor shall at all times be an independent contractor and nothing in the contract shall be construed as creating a relationship of employer and employee between the Contractor and the Construction Sub-Contractor or any of the Construction Sub-Contractor's employees.'

[10] In terms of clause 8.1 CGM was obliged to carry out and complete the works in accordance with the construction contract. CGM warranted that 'the design and construction of the works will be undertaken with all reasonable skill and care to be expected of a qualified and experienced contractor with experience in the construction of works of a similar type, nature and complexity to that of the works'.<sup>5</sup>

[11] In terms of clause 8.3.14 CGM accepted responsibility 'for the provision of' and bore 'all risks in relation to all goods, materials and labour necessary for the provision of the works'. Clause 17.1 required 'materials and goods' to meet prescribed standards and CGM undertook in terms of clause 17.4 to provide SACS on request 'with all the necessary supporting documentation to prove that the materials and goods comply with clause 17.1 hereof'.

[12] Clause 36.1 provided for a contract price of R303 000 000 for 'the performance and delivery of the works'. The term 'works' is defined by clause 1.2.103 to mean 'all the construction services and activities associated with or necessary to provide the prison'.

[13] In order to finance the project and to meet its other obligations in terms of the concession contract, SACS entered into agreements with BoE Merchant Bank and First Rand Bank for loans of R384 000 000. These banks required security which was provided in the form of guarantees given by the South African Government and the shareholders of SACS.

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<sup>5</sup>Clause 8.3.4. It is but one of a number of warranties given by CGM.

[14] The government undertook to guarantee 80 percent of the loan while the shareholders of SACS guaranteed the remaining 20 percent. The GEO Group's share of the guarantee was provided by a company in the group, Wackenhut Corrections Corporation. In terms of a guarantee and put agreement, SACS was required to pay Wackenhut what was termed a guarantee fee of R15 561 131. Later, during the tendering stage, SACS was required to pay a bid guarantee fee to its financial advisor, African Merchant Bank (AMB) of R77 333. The guarantee fees thus totalled R15 638 464.

[15] Kensani was unable to provide a guarantee in the same way. Instead, it advanced a loan to SACS equivalent to the liability guaranteed by Wackenhut. In consideration for this, SACS agreed to pay Kensani an introduction fee of R47 484 608.

[16] In consideration for the financial advisory services provided to SACS by AMB, SACS agreed to pay AMB a financial advisory fee of R6 209 274, as well as a margin fee of R2 545 077 in respect of its negotiations for loans with BoE Merchant Bank and First Rand Bank.

[17] In addition, SACS was obliged to pay a commitment fee and an initial fee to BoE Merchant Bank and First Rand Bank, administration fees to First Rand Bank and legal fees to its attorneys, Deneys Reitz. It also incurred interest on the loan facilities.

[18] Apart from the various fees that were payable by SACS, it incurred expenses of R228 821 436 in respect of the building of the prison and R95 558 256 in respect of provisioning it, an amount of R324 379 692. The total amount involved, made up of the construction and equipping costs and the financial costs was R464 376 824.

[19] The prison was designed and built in accordance with the specifications contained in the concession contract. It had to last for 50 years, although SACS would only operate it for 25 years. The prison was brought into use during February 2002.

[20] SACS entered into three sub-contracts for the running of the prison. They were with South African Custodial Management (Pty) Ltd to provide security, administration and overall management of the prison, with Kensani Corrections Management (Pty) Ltd to provide routine maintenance, inmate programs and purchasing services and with Royal Food Correctional Services (Pty) Ltd to provide food services.

[21] The prison is the infrastructure of the Department of Correctional Services. SACS occupies it as a service provider to the Department. It is managed by a member of SACS's staff known as the director. This person's appointment, powers and functions, as well as those of his or her staff, are regulated by ss 107 to 110 of the Correctional Services Act. The operation of the prison is supervised by a member of staff of the Department, termed a controller, whose appointment, powers and functions are set out in the ss 105 and 106 of the Act. SACS earns fixed and variable income from its running of the prison in terms of the concession contract, the fixed fee income being, for all intents and purposes, payment for the construction of the prison. It is payable over a period of 18 years.

#### The first issue: the finality of the 2002 assessment

[22] The Commissioner issued an assessment to SACS for the 2002 year of assessment that had as its due date – and hence the date of assessment – 1 June 2004. On 5 June 2006, SACS wrote to the Commissioner requesting a reduced assessment in terms of s 79A of the Act on the basis that certain expenses that qualified for deduction had not been claimed as deductions in its tax returns for the 2001 to 2004 years of assessment. This letter was served on the Commissioner on 15 September 2006.

[23] By letter dated 11 December 2006, and headed 'INCOME TAX: YEARS OF ASSESSMENT 2001 TO 2004', the Commissioner stated that the 'proposed adjustments' to his amended tax computation 'to give effect to the above are set out below'. On 4 May 2007, the Commissioner sent a letter to SACS which was headed 'INCOME TAX: REVISED ASSESSMENTS FOR THE YEARS OF ASSESSMENT 2001 TO 2004'. The letter responded to a number of issues that

had been raised by SACS, such as the deductibility of the construction costs of the prison in terms of s 11(a) of the Act, and whether the materials used to build the prison qualified as trading stock for purposes of s 22(2A), to name but two. After having dealt with each issue, the Commissioner stated:

'In the revised assessments below I have added back to taxable income the R1 719 920 interest claimed as a deduction in the 2001 year on the basis that the taxpayer had not commenced trading in 2001 and allowed, under section 11(bA) of the Act, the deduction claimed in the 2002 year of R46 819 508.'

[24] Under a heading: 'Revised assessments', the Commissioner stated that the 'adjustments to give effect to the above are set out below'. In respect of the 2002 year it is indicated in the letter that the assessed loss of R94 617 364 in the original assessment was reduced to R93 652 364. The letter concluded with the following:

'Tax assessments will be issued to you in due course.

If you are not in agreement with the assessments, you have the right to lodge an objection in terms of section 81 of the Act. The objection must be in writing in the prescribed form ADR1 which is available from any SARS office or can be accessed on the SARS website . . .

The objection must be lodged with this office within 30 calendar days of the date of assessment.'

[25] On 14 August 2007 SACS requested reasons for the revised assessments. It received a response dated 21 August 2007 in which it was stated:

'I am required, where adequate reasons were not supplied in my letter of assessment dated 4 May 2007, to explain my decisions. I am not required to debate further issues with you or to enter into further debate on the issues already addressed in my letter.'

The letter continued to say that '[m]y assessment letter to you dated 4 May 2007 sets out the areas of dispute and the reasons for the stance taken by me' and that 'I did not revise the assessments for 2001 and 2002 as these had prescribed in terms of section 79 of the Act'.

[26] SACS lodged a notice of objection dated 19 September 2007 in which it described the year of assessment to which it applied as '2003-2004; alternatively



2002'. The Commissioner's response stated inter alia that '[t]his letter should be read in conjunction with my letter of assessment dated 4 May 2007 and my letter dated 21 August 2007 providing reasons for the assessments'. Later, however, it is stated in relation to the 2002 assessment:

'No objection to the 2002 assessment was received within the three year period after the date of assessment. Consequently the 2002 assessment is final and conclusive.'

[27] Section 79A of the Act provides:

'(1) The Commissioner may, notwithstanding the fact that no objection has been lodged or appeal noted in terms of the provisions of Part III of Chapter III of this Act, reduce an assessment-

- (a) to rectify any processing error made in issuing that assessment; or
- (b) where it is proved to the satisfaction of the Commissioner that in issuing that assessment any amount which-
  - (i) was taken into account by the Commissioner in determining the taxpayer's liability for tax, should not have been taken into account; or
  - (ii) should have been taken into account in determining the taxpayer's liability for tax, was not taken into account by the Commissioner:

Provided that such assessment, wherein the amount was so taken into account or not taken into account, as contemplated in subparagraph (i) or (ii), as the case may be, was issued by the Commissioner based on information provided in the taxpayer's return for the current or any previous year of assessment.

(2) The Commissioner shall not reduce an assessment under subsection (1)-

- (a) after the expiration of three years from the date of that assessment; or
- (b) ...'

[28] It was argued by the Commissioner that the letter of 4 May 2007 was not a revised assessment and that, three years after the date of assessment (1 June 2004), the assessment for the 2002 year of assessment became final. SACS, on the other hand, argued that the letter of 4 May 2007 is indeed a revised assessment and consequently that the assessment for the 2002 year of assessment had not become final.

[29] An assessment is defined in s 1 of the Act as 'the determination by the Commissioner, by way of a notice of assessment (including a notice of

assessment in electronic form) served in a manner contemplated in section 106(2) . . . of an amount upon which any tax leviable under this Act is chargeable'. In *ITC 1740*<sup>6</sup> Galgut DJP held that in order to fall within this definition, 'what is required is at least a purposeful act, one whereby the document embodying the mental act is intended to be an assessment'.

[30] On its face, with one exception, the letter of 4 May 2007 purports to be a determination as envisaged by the definition: it calls itself a revised assessment; it responded to the issues raised by SACS when it requested a reduced assessment in terms of s 79A; it spoke, in the body of the document, of the 'revised assessment below', in explaining the decisions encapsulated in it; and it purported to make an adjustment under a heading 'Revised assessment'. It is apparent from these features that the letter records a determination.

[31] The only indication that runs counter to the indications I have listed is the sentence that reads: 'Tax assessment will be issued to you in due course.' It was conceded by counsel for the Commissioner that if the letter had not contained this last sentence the argument that it was not an assessment would have been closed to him. Counsel for SACS argued that not too much must be read into the sentence. It was simply intended to convey to SACS that, the determination having been made, the appropriate computer-generated IT 34 form would in due course be completed and sent to SACS.

[32] In my view, the overwhelming impression created by the letter of 4 May 2007 is that it is, indeed, an assessment: it determines, in a reasoned manner, the request made by SACS for a reduced assessment in terms of s 79A. The last sentence, when viewed in the context of the letter as a whole, must therefore be taken to mean no more than an expression of intent on the part of the Commissioner to despatch in due course the IT34 form to formally record the decision that had already been taken.

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<sup>6</sup>65 SATC 98 at 104E-F.

[33] I accordingly conclude that there is no merit in the point that the original assessment for the 2002 year of assessment had become final in terms of s 79A(2) of the Act.

The second issue: the construction of the prison

[34] SACS argued that, in the construction of the prison, it carried out a trade; the materials that were used to construct the prison constituted its trading stock; those materials, when they were built into the prison, acceded to the prison – and hence became the property of the State – and that, as a result, the materials were deemed to be trading stock held and not disposed of by it in terms of s 22(2A) of the Act; and that consequently, being expenditure actually incurred, and not being of a capital nature, the cost of the construction of the prison was a permissible deduction from SACS's income in terms of s 11(a) of the Act.

[35] Section 1 defines the term 'trade' to include 'every profession, trade, business, employment, calling, occupation or venture . . .'. The same section defines the term 'trading stock' (at the time applicable to this matter) to include anything:

- '(i) produced, manufactured, constructed, assembled, purchased or in any other manner acquired by a taxpayer for the purposes of manufacture, sale or exchange by him or on his behalf; or
- (ii) the proceeds from the disposal of which forms or will form part of his gross income . . .'

[36] Section 22 of the Act concerns itself with amounts to be taken into account in respect of values of trading stocks. It provides:

'(1) The amount which shall, in the determination of the taxable income derived by any person during any year of assessment from carrying on any trade (other than farming), be taken into account in respect of the value of any trading stock held and not disposed of by him at the end of such year of assessment, shall be-

- (a) in the case of trading stock other than trading stock contemplated in paragraph (b), the cost price to such person of such trading stock, less such amount as the Commissioner may think just and reasonable as representing the amount by which the value of such trading stock, not being shares held by any

company in any other company, has been diminished by reason of damage, deterioration, change of fashion, decrease in the market value or for any other reason satisfactory to the Commissioner; and

(b) . . .

(1A) . . .

(2) The amounts which shall in the determination of the taxable income derived by any person during any year of assessment from carrying on any trade (other than farming), be taken into account in respect of the value of any trading stock held and not disposed of by him at the beginning of any year of assessment, shall-

(a) if such trading stock formed part of the trading stock of such person at the end of the immediately preceding year of assessment be the amount which was, in the determination of the taxable income of such person for such preceding year of assessment, taken into account in respect of the value of such trading stock at the end of such preceding year of assessment; or

(b) if such trading stock did not form part of the trading stock of such person at the end of the immediately preceding year of assessment, be the cost price to such person of such trading stock.

(2A) (a) Where any person carries on any construction, building, engineering or other trade in the course of which improvements are effected by him to fixed property owned by any other person, any such improvements effected by him and any materials delivered by him to such fixed property which are no longer owned by him shall, until the contract under which such improvements are effected has been completed, be deemed for the purposes of this section to be trading stock held and not disposed of by him.

(b) For the purposes of paragraph (a), a contract shall be deemed to have been completed when the taxpayer has carried out all the obligations imposed upon him under the contract and has become entitled to claim payment of all amounts due to him under the contract.'

[37] Section 11(a) provides that, for 'the purpose of determining the taxable income derived by any person from carrying on any trade, there shall be allowed as deductions from the income of such person so derived . . . expenditure and losses actually incurred in the production of the income, provided such expenditure and losses are not of a capital nature'.

[38] It is not necessary to determine whether the expenditure incurred by SACS for the construction of the prison was expenditure of a capital nature for

purposes of s 11(a).<sup>7</sup> This issue is not relevant because the case turns instead on s 22, and particularly s 22(2A) of the Act.

[39] In *Richards Bay Iron and Titanium (Pty) Ltd & another v Commissioner for Inland Revenue*,<sup>8</sup> Marais JA dealt with the purpose and function of s 22. He stated:<sup>9</sup>

'The rationale for the existence of these provisions is neither far to seek nor difficult to comprehend. The South African system of taxation of income entails determining what the taxpayer's gross income was, subtracting from it any income which is exempt from tax, subtracting from the resultant income any deductions allowed by the Act, and thereby arriving at the taxable income. It is on the latter income that tax is levied. The concepts involved are defined in the Act. *Commissioner for Inland Revenue v Nemojim (Pty) Ltd* 1983 (4) SA 935 (A) at 946G-H. Where a taxpayer is carrying on a trade, any expenditure incurred by him in the acquisition of trading stock is deductible in terms of s 11(a) of the Act because it is expenditure incurred in the production of income, and it is not of a capital nature. Income generated by the sale of such stock is of course part of the trader's gross income. Where in his first year of trading a trader has bought, and thereafter sold, all the stock which he acquired during that year, no problem arises. There will be a perfect correlation between the trading income earned and the expenditure incurred in that particular year in purchasing and selling the stocks sold, and the difference between the two sums will give a true picture of the result of the year's trading. There will be no stock on hand at the close of the year of which account need be taken. Contrast with that situation a situation in which the trader, having sold all the stock acquired earlier during that year at a substantial profit, purchases large quantities of stock just prior to the close of his tax and trading year. If he were permitted to deduct the cost of purchasing that stock from the income generated by his sales, without acknowledging the benefit of the stock acquired, he would be escaping taxation in that year on income which otherwise would have been taxable by the simple expedient of converting it into trading stock of the same value. That process could be repeated every year *ad infinitum*. It is true that there would ultimately have to be a day of reckoning when trading finally ceases, but the fact remains that the taxpayer will have been enabled to avoid liability for tax until that point is reached. Where the trader is an

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<sup>7</sup>As to the method of determining whether expenditure is of a capital or revenue nature, see *New State Areas Ltd v Commissioner for Inland Revenue* 1946 AD 610 at 627; *Commissioner, South African Revenue Service v BP South Africa (Pty) Ltd* 2006 (5) SA 559 (SCA) para 23.

<sup>8</sup>*Richards Bay Iron and Titanium (Pty) Ltd & another v Commissioner for Inland Revenue* 1996 (1) SA 311 (A).

<sup>9</sup>At 316F-317C.

individual who is subject to rising marginal tax rates as his trading profit increases, he would be enabled to so regulate his apparent profit that he immunised himself from them indefinitely.'

[40] Later in the judgment Marais JA stated that there was no reason to doubt 'that it was for these reasons that the South African legislation too requires opening and closing trading stock to be taken into account when determining taxable income derived from carrying on any trade in any year of assessment'.<sup>10</sup>

[41] The crisp issue to be decided is whether SACS's activities fall within the terms of s 22(2A). It is convenient to dispose of a preliminary argument at the outset. It was argued on behalf of SACS – and the court below found this to be the case – that the section deems what may not be trading stock to be trading stock and in this sense 'overrides' s 11(a). I am of the view that this interpretation is not correct when consideration is given to the purpose of the section. It is necessary to deem materials to be trading stock for purposes of the benefit provided by the section because, having acceded to the land upon which they have been built, the materials in question ceased to be owned by the person who had acquired them. The trading stock is deemed to have been 'held and not disposed of' by the person who had acquired it for purposes of effecting improvements to the fixed property of another: the deeming provision qualifies this phrase and not the term trading stock. It does not 'override' s 11(a) by deeming expenditure of a capital nature to be expenditure of a revenue nature.

[42] The question to be answered is whether SACS ever held trading stock in the form of materials and equipment that were built into the prison or, put slightly differently, did it ever effect improvements to the fixed property of the State by delivering materials and equipment to that property which it then built into the prison, thus losing ownership of the materials and equipment.<sup>11</sup> The court below

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<sup>10</sup>At 318C.

<sup>11</sup>It is not necessary to deal with the definition of trading stock although it may be accepted that the materials that were used to build the prison were trading stock. As for the interpretation of the term trading stock, see *De Beers Holdings (Pty) Ltd v Commissioner for Inland Revenue* 1986 (1) SA 8 (A) at 32E-33C; *Richards Bay Iron and Titanium (Pty) Ltd & another v Commissioner for Inland Revenue* (note 8) at 324H-325F.

held that it did, because CGM, its sub-contractor, was its agent. Claasen J dealt with this issue thus:

'The second question is the submission by the Respondent that because it operated through sub-contractors it was itself not really *trading* as such and therefore could not become a *trader* as per the definition thereof in the Act. There is no merit in this argument either: "*Qui facit per alium, facit per se.*" This principle is part of our law. It simply means that he who acts through agents, acts himself. It is thus clear that whatever the Applicant really is and however it might have operated whatever it did, it did by and through itself. Therefore all the definitions regarding trader and trading stock, etc. must be viewed in the light that they apply to the Appellant directly and not to any of its sub-contractors.'

[43] In order to determine whether the court below was correct, it is necessary to have regard to the essential features of the construction contract between SACS and CGM. In terms of the construction contract, CGM undertook to build and equip a prison – to perform 'all the construction services and activities associated with or necessary to provide the prison' – on land owned by the State, for which SACS undertook to pay a set price. The relationship between SACS and CGM was expressly stated not to be an employment relationship. Although not expressly stated, it is evident that CGM was not SACS's agent either. It acted as an independent contractor and it gave a range of warranties as to the quality of its work and of the materials that it was to use that are incompatible with a relationship of principal and agent. It stood in relation to SACS as any construction company would in relation to a client for whom it had undertaken to construct a building. In terms of clause 8.3.14, CGM undertook to provide 'all goods, materials and labour necessary for the provision of the works'. From this it can be concluded that SACS never provided the materials or the equipment that were built into the prison, and never owned them at any stage. CGM did.

[44] Reliance was placed by counsel for SACS on *Timberfellers (Pty) Ltd v Commissioner for Inland Revenue*<sup>12</sup> as support for the proposition that SACS was entitled to the benefits of the deductibility of the cost of the trading stock acquired by CGM and built into the prison because it had built the prison through the

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<sup>12</sup>*Timberfellers (Pty) Ltd v Commissioner for Inland Revenue* 59 SATC 155.

agency of CGM. The facts of *Timberfellers* distinguish it from this case. In it, debts due to Timberfellers were collected by two agents, its attorneys and its accountant. In this case, as I have shown, CGM was not an agent of SACS when it built the prison and the materials that it built into the prison were never the property of SACS. While the 'ordinary rule that *qui facit per alium facit per se*'<sup>13</sup> was clearly applicable to Timberfellers on the facts of that case, it is as clearly not applicable to SACS on the facts of this case.

[45] From the above, I conclude that SACS does not fall within the parameters of s 22(2A). It never carried on 'any construction, building, engineering or other trade in the course of which improvements' were effected by it to the fixed property of the State. As it never effected any improvements and never delivered materials to the State's fixed property, it never held any trading stock for purposes of the section that could be deemed to be trading stock that was held and not disposed of by it. It seems to me that CGM would have been entitled to a deduction in terms of s 22(2A) because its activities appear to fall squarely within the terms of the section and to correspond to the purpose of the section.

[46] I conclude accordingly, that SACS is not entitled to the deduction contended for by it in terms of s 22(2A), read with s 11(a). The Commissioner's appeal must succeed to this extent.

#### The third issue: the deductibility of the various fees

[47] In order to bid for the tender and to raise the loans that it required to finance the construction of the prison, SACS incurred a number of fees payable to various parties. The individual fees, their purpose and the parties to whom they were paid have been set out above. SACS also incurred interest on its loans. It claims to be entitled to a deduction in respect of the various fees and the interest in terms of s 11(bA) of the Act.

[48] Section 11(bA) provides:

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<sup>13</sup>At 163.



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

. . .

(bA) any interest (including related finance charges) which is not otherwise allowable as a deduction under this Act, which has been actually incurred by the taxpayer on any loan, advance or credit utilized by him for the acquisition, installation, erection or construction of any machinery, plant, building, or any improvements to a building . . . to be used by him for the purposes of his trade, and which has been so incurred in respect of a period prior to such machinery, plant, building, improvements . . . being brought into use for the purposes of the taxpayer's trade, such deduction to be allowed in the year of assessment during which such machinery, plant, building, improvements . . . is or are brought into use for the said purposes.'

[49] The interest that SACS has incurred is, in my view, deductible in terms of s 11(bA): it has been 'actually incurred' by SACS on its loans from BoE Merchant Bank and First Rand Bank to pay CGM for the construction of the prison. I am also of the view that the various fees are deductible in terms of s 11(bA): because of their close connection to the obtaining of the loans and the furtherance of SACS's project, they qualify as 'related finance charges' for purposes of the section.

[50] Consequently, SACS succeeds on this aspect. I consider it necessary, however, to refer the matter back to the Commissioner for a decision to be taken as to the precise quantum of the deduction in the light of the principle set out in *Caltex Oil (SA) Ltd v Secretary for Inland Revenue*<sup>14</sup> that the interest and fees had to have been actually incurred during the year of assessment in which the deduction was sought.

### Costs

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<sup>14</sup>*Caltex Oil (SA) Ltd v Secretary for Inland Revenue* 1975 (1) SA 365 (A) at 374B-F.

[51] In the court below, no costs order was made because, in terms of s 83(17) (a) of the Act, the Commissioner's opposition was not unreasonable. Even though the order of the court below will be set aside and replaced with an order that reflects only partial success for SACS, there remains no need to make a costs order: the Commissioner's opposition to the s 11(bA) issue was not unreasonable and SACS's unsuccessful appeal in respect of the s 22(2A) issue was not frivolous (in terms of s 83(17)(b) of the Act). In this court, different considerations apply. The Commissioner was substantially successful and is entitled to the costs of the appeal.

#### The order

[52] The following order is made:

- 1 The appeal is upheld in part.
- 2 The respondent is directed to pay the costs of the appellant, including the costs of two counsel.
- 3 The order of the court below is set aside and replaced with the following:  
'The assessment is referred back to the Commissioner for him to determine the amount that is deductible from the appellant's income in terms of s 11(bA) of the Income Tax Act 58 of 1962.'

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C Plasket  
Acting Judge of Appeal

APPEARANCES

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