REPUBLIC OF SOUTH AFRICA

NORTH GAUTENG HIGH COURT

PRETORIA

CASE NO: *413/07*
ITC CASE NO: 11029

In the matter between:

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICES	Appellant
and	
I-NET BRIDGE (PTY) LIMITED	Respondent

JUDGMENT

(Argument heard on 2 December 2009 and judgment delivered on 15 September 2010)

VICTOR J:

[1] This is an appeal in terms of Section 86A(2)(a) of the Income Tax Act (Income Tax Act) against a judgment of the court a quo after the appellant was granted leave to appeal after a successful petition to the Supreme Court of Appeal.

[2] The Tax court a quo which sat for two days upheld the respondent's appeal against the appellant for its refusal to allow the amount of R41 million as a deduction in terms of Section

11(a) of the Income Tax Act. On 15 March 2001 the appellant notified the respondent that it regarded the expenditure as being of a capital nature which did not qualify for deduction.

[3] The essence of this appeal lies in the proper interpretation of the agreements concluded between the parties and in particular the meaning of what the licence fee was paid for. The respondent paid a licence fee to a UK company for the use of *"electronic content, data and information".* This payment was made over a five year period. The payment was made by way of the issue of shares in a UK company in the amount of R9 million and by the creation of a loan account in favour of the UK company in the amount of R32 million. A further aspect for analysis is whether that mode of payment described is to be interpreted as fixed capital or circulating capital, the latter being deductible as a revenue expense.

[4] Mr Campbell SC on behalf of the respondent described the *"electronic content, data and information"* as a consolidated data feed or parcels of data feed which constitutes trading stock (floating capital). In order to access these bundles of data, associated software and maintenance thereof is required.

[5] The respondent contends that the acquisition of the data systems is not infrastructure which could be utilised for other purposes. This was not a situation akin to the acquisition of buildings or forests. In other words the software was specifically designed for the type of data received and could not be used for any other IT technological purpose.

[6] The respondent submitted that a very simple analogy could definitively demonstrate the principle, for example, when milk is purchased from a supermarket, one could not purchase milk without the container. The cost of acquiring the container was clearly deductible. The

purchase of this system was akin to the container for the milk without which the milk could not be sold. The software and licence could not be used for any other purpose other than the reading of these parcels of data. Any change in the "decoder" and the data could not be read.

[7] The assessment of whether an item constitutes a payment in respect to revenue or capital must turn on its particular facts.

> *"The deductibility of expenditure..... is a much frequented area of dispute between taxpayers and Revenue in which the governing principles are settled and familiar. But because facts of one case are rarely the same as those of any other, the authorities, in giving prominence to considerations occasioned by their particular facts, are often unhelpful in solving the problems which arise in later cases, more especially those which arise in changed commercial circumstances"*[1]

[8] Ms Finlayson who testified on behalf of the respondent described the conversion process of this data into a readable and usable format as requiring a type of internet decoder. I-Net then had to install particular software on the computers of their customers. The system for which the R41 million was paid was trading stock and the respondent sells this trading stock in order to generate a profit, therefore, the expenditure should be treated as revenue. The appellant contended for the converse. When the agreement was concluded with I-Net Bridge (Pty) Ltd the data was received in a consolidated format as a parcel of data feed.

THE AGREEMENTS

[9] The respondent concluded a number of agreements in order to consolidate its data feed

[1] Beauchamp (Inspector of Taxes v FW Woolworth plc 1988 STC 714

viz. a sale of business agreement, the licence agreement and the shareholders agreement. According to the appellant these agreements should be read together and upon a proper construction meant that the respondent had acquired a capital asset. This requires analysis particularly in the light of the undisputed evidence of Ms Finlayson that it was the trading stock that generated the profit for the respondent.

[10] Central to this appeal is the relevant clause in the licence agreement, clause 6, for payment of the licences:

> *6.1 In consideration for the licence to use the Bridge system, but expressly excluding the Source Code, I-Net Bridge shall pay Bridge R5 560 000 per annum for the Initial Period.*
>
> *6.2 In consideration for the licence to use the Bridge Source Code, I-Net Bridge shall pay Bridge R1 640 000 per annum for the Initial Period.*
>
> *6.3 The aforegoing consideration, being a total of R41 000 000, shall be payable in advance in the manner recorded in 6.4.*
>
> *6.4 In full and complete discharge of the consideration referred to in 6.1 and 6.2, and:*
>
> *6.5 In consideration for the licence to use the Bridge System, the Bridge Data Feed and the Bridge Source Code, and:*
>
> *6.5.1 Against payment of an additional sum of US $200 000; and*
>
> *6.5.2 Against delivery to {-Net Bridge of a written undertaking by Bridge to deliver the Bridge System and Source Code as and when required by I-Net Bridge,*

I-Net Bridge shall:

6.5.3 Allot and issue to Bridge 200 ordinary power value shares in I-Net Bridge, at a premium of 10 058 558 (being equal to 25% of the issued share capital of I-Net Bridge); and

6.5.4 Credit Bridge with a loan account of R32 million.

6.6 Bridge shall sign all documents and perform all acts necessary to get effect to the delivery of the Bridge System and Source Code to I-Net Bridge, in particular, but without limiting this general obligation a *registered user agreement in respect* of *the Bridge Trade Mark."*

[11] The appellant contends that upon a proper reading of clause 6, the R41 million was not paid for the data feed but only for the Bridge System and the Bridge Source Code. It omits to take into account the provisions of clause 6.5 which also includes of the Bridge Data System. The appellant contends that the court a *quo* erred in finding that no *fixed* asset was acquired or created. Upon a proper construction of clause 6 above and based on the evidence of Ms Finlayson on behalf of the respondent, it is clear that the items being the Bridge system, the Bridge Source Code and the Bridge Data System are all interrelated. Without one component there would is no readable data. Clause 6 must be read in its entirety and contextually. The Bridge System and the Bridge Source Code are but instruments in the entire process.

[12] The submission by the appellant that the contents of clause 6 can only mean that the acquisition of the systems is of a capital nature and not allowable as a deduction in terms of section 11(a) of the Income Tax Act needs closer analysis.

[13] In my view the mere mode of payment cannot of its own, turn floating capital (trading stock) into capital infrastructure. The appellant sets out the history of the respondent's acquisition. In order not to breach the rules of the Johannesburg Stock Exchange it established I-Net, the respondent. When the Johannesburg Stock Exchange was de-regulated it sought a global player who could actually provide a far broader range. It found Bridge, an American company, which was a supplier of data from every stock exchange and other financial sources around the world and it was in a position to supply the type of data required.

[14] The respondent, I-net, was born of a joint venture between Times Media Ltd (the owners of Business Day, Financial Mail and Sunday Times) and IJRCS a company incorporated by stockbrokers. The respondent had previously subscribed to various local and international data services and on-sold this information to its customers. It paid for these services at the rate of approximately R8 million per annum and the appellant had allowed these deductions.

[15] The appellant described the respondent's relationship with Bridge. It refers to the following: a letter of intent made it clear that the parties intended to participate in a long-term venture, the various agreements which show that the licence agreement formed an integral part of the capital structure of the respondent's profit generating apparatus; the sale of business and licence agreement were concluded at the same time and the operation of each was made suspensive on the conclusion of the other; the licence agreement granted the respondent the sale exclusive and non-transferable licence to use Bridge material in the Republic of South Africa. All these features according to the appellant demonstrate capital expenditure and not revenue expenditure.

THE LAW

[16] In my view the Substance and not the form of the various agreements must be considered. I am in respectful agreement with Bertelsman J and his assessors when they found that the license was the key that provided access to the data and without the Bridge System, the Bridge Data Feed and Bridge code there would be no access to the data and would be of no practical value whatsoever. Reliance was correctly placed on the reasoning in City Link Melbourne Ltd v Federal Commissioner of Taxes[2]. In that case the payment was to acquire the right to operate the system and not to buy equipment. As testified by Ms Finlayson, a decoder is not equipment in the capital expenditure sense. There was no material before the court other than the evidence of Ms Finlayson. The failure by the appellant to call evidence to the contrary means that evidence would not have assisted the appellant.

[17] Section 11(a) of the Income Tax Act for the period 1999 and 2000 provides: *"General Deductions allowed in determination of taxable income - 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 -*

> *(a) expenditure and losses actually incurred in the republic in the production* of *income, provided such expenditure and losses are not of* a *capital nature."*

[18] The appellant relies on a number of cases where the mechanism necessary for generating income and expanding the size of the business is regarded as capital[3]. The facts in this case as testified to by Ms Finlayson do not place the "decoder" into the genre

[2] 257 ATR 316 (FCAFC)

[3] New State Areas Ltd v Commissioner for Inland Revenue 1946 AD 610 at 727, Commissioner for Inland Revenue v George Forest Timber Co Ltd 1924 AD 516 at 526-7; Rand Mines (Mining and Services) Ltd v CIR 1997 (1) SA 427, African Greyhound Racing Association (Ply) Ltd v Commissioner for Inland Revenue 1945 TPD 344 at 349; CIR v Cadac Engineering Works (Pty) Ltd 1965 (2) SA 511 (A) at 523B-H

contended for by the appellant. Regard must also be had to the distinction between once and for all expenditure and expenditure of a recurring nature or expenditure to meet a continuing demand[4]. Ms Finlayson testified that the "decoder" was not a capital expense in the sense of acquiring infrastructure.

[19] Appellant's reliance on the enduring benefit test[5] as signifying capital expenditure is not of itself decisive. In this regard the appellant contended that the agreements provide for a long term relationship and this corroborated that there would be an enduring benefit. The import and context of the expenditure has to be analysed. The long term arrangement was not unlike the data the respondent had purchased previously from different sources. The appellant did not lead any evidence to demonstrate the contrary. Hence enduring benefit on its own is unhelpful.

[20] The agreements in evidence are not on their own of assistance and decisive of the issue as to whether the expenditure is of a capital nature or not. Such an analysis cannot be done without considering the critically integrated features of the data feed. The *expenditure* for the data feed was more closely related to the income-producing activities of on-selling data than to the acquisition of infrastructure. The day to day activities of the software is such that the expenditure is more closely linked to producing revenue.

CONCLUSION

[21] In my view the true legal nature of the transactions show that the expenditure is for the acquisition of data being the "trading stock" and the money outlaid for the acquisition of the integrated system was its floating capital used wholly for the purposes of trade. The

[4] Tucker (Inspector of Taxes) v Granada Motorway Services Ltd [1979] All ER

[5] *Commissioner for Intand Revenue v African Oxygen Ltd* 1963 (1) SA 681 (A)

expenditure is not an enduring asset[6], nor a once and for all payment. (Payment 5 years in advance does not change its character as an annual fee). A valid commercial reason was given for fixing the price upfront over a 5 year period, namely, the depreciating rand currency at the time. The expenditure did not alter the nature of the business; it made the trading stock more attractive. The import of Ms Finlayson's evidence that the Bridge software was the "packaging" required for the respondent to receive data feed has not been challenged technically by the appellant.

[22] It is the appellant's position that the R41 million created an income - producing structure which was not deductible. This cannot be correct in the light of the unique aspects testified to by Ms Finlayson and upon a proper application of the principles referred to above.

[23] The appellant also appeals the cost order of two days made by the court a quo and submits that the order should at best be in respect of one day. It is a discretion exercised by Bertelsman J and there is no basis before me to interfere with that discretion.

[24) For the reasons and considerations referred to, I am of the view that the Income Tax Court a quo did not err in regarding the expenditure of R41 million as a deductible expense,

The order I would make is the following:

1. The appeal against the cost order made by Bertelsman J is dismissed.

2. The appeal is dismissed with cost being the cost of senior counsel.

[6] ITC 527 1942 (12) ITC 430

VICTOR

JUDGE OF THE HIGH COURT

I concur

RAILUNGA

JUDGE OF THE HIGH COURT

I concur

ISMAI

ACTING JUDGE OF THE HIGH COURT