Republic of South Africa

In the High Court of South Africa
(Western Cape Tax Court, Cape Town)

Case No: 11470

In the matter between:

ABC Ltd — Appellant

And

The Commissioner for the
South African Revenue Service — Respondent

Judgment delivered: 14 March 2011

LOUW J

[1] In 2001 the ABC group of companies merged with the LC Corporation group of companies. Prior to the merger the appellant, then known as ABC Ltd, was a wholly owned subsidiary of ABC Holdings Ltd which company was in turn wholly owned by ABC Group Ltd.

[2] I shall refer in this judgment to the appellant as Limited and to ABC Group Ltd, as ABC Group.

[3] On 1 February 1991 F Co, a subsidiary of GF plc, both based in the United Kingdom, concluded a joint venture agreement (the JV agreement) with Group and LC Corporation (SA) Ltd. The JV agreement led to the formation of G Co. in which ABC Group and LC Corporation SA Ltd each held a 25 percent shareholding and F CO. held the other 50 percent shareholding.

[4] Pursuant to the JV agreement and foreshadowed in that agreement, a further agreement, referred to in the papers and the evidence as the distribution agreement was concluded on 12 May 1992 between F Co. and an entity referred to in the agreement as 'ABC'. The identity of the party who contracted with F Co. is in dispute. Limited contends that it is the entity that contracted with F Co. while the respondent states that ABC Group is the party who contracted with F Co. For purposes of this judgment I will accept, without finding, that Limited is the entity which entered into the distribution agreement with F Co.

[5] In terms of the distribution agreement:

1. Limited was appointed as the exclusive distributor for resale in South Africa, Lesotho, Botswana and Swaziland (the designated territory) of JK whisky, YZ whisky and ST whisky (the designated whiskies), for a period of ten years commencing on 1 February 1991, terminable thereafter on a notice period of one year. The exclusive distribution right was consequently, depending on when notice of termination is given, due to terminate on 31 January 2002 or any time thereafter.

2. Limited undertook not to distribute any products which compete with the designated whiskies in the designated territory.

[6] Of the three designated whiskies covered by the distribution agreement, JK whisky was by far the most important both as to volume sold and as to income generated. Unless the context otherwise demands, I will for ease of reference refer to the three designated whiskies as JK.

[7] On 17 December 1997 two major UK companies, MM plc and GF plc merged. The merger of these two companies brought together the spirit and wine businesses of F CO. and of F Co. and DP Ltd and resulted in a structural change in the liquor market in Europe. The merger resulted in a further consequence for the liquor trade in South Africa. In order to accommodate the changes brought about in Europe in South Africa, F Co. sought the termination of the JV agreement and approached Limited with a proposal for the early cancellation of the distribution agreement.

[8] Negotiations ensued and culminated in the conclusion of the dissolution agreement on 27 August 1998. It provided for the termination of the distribution agreement against F Co. paying Limited R67m. In the result, the distribution agreement came to an end some 41 months before F Co. could, by giving notice in terms of the agreement, have terminated the distribution agreement without paying any compensation.

[9] In an additional assessment of Limited for the 1999 tax year, the respondent levied income tax and interest on the amount of R67m received by Limited. Limited objected to the assessment on the basis that the amount received was of a capital nature and that no income tax was payable on the receipt of the amount. The objection was rejected by the respondent, hence this appeal.

[10] The first issue to be decided on appeal is whether the R67m is of a revenue or capital nature.

[11] The second issue to be decided arises only if the assessment is not set aside and is whether the respondent was correct in declining to exercise its discretion in terms of section 89 quat (3), to waive interest payable in terms of section 89 quat (2) on the underpayment of provisional tax and whether this court should set aside the decision and substitute its own decision in terms of section 89 quat (5).

[12] On appeal, Limited adduced the evidence of the following witnesses: its erstwhile managing director, Mr. Y, Mr. Z a chartered accountant, as an expert witness, Mr. X, a chartered accountant who was the erstwhile Corporate Strategy and Planning manager of Limited, Mr. N, who was the managing director of F Co. at the time and Mr. O, the executive chairman of S Liquors, a chain of 39 discount liquor stores. The respondent called no witnesses.

[13] JK is a proprietary brand of whisky and carries a premium on its price. In contrast, a cut price whisky is bought because of its price. Although JK has over the years held a modest position internationally amongst the top 100 distilled products generally and amongst whiskies in particular, in South Africa, JK has for many years been the market leader in volume and value, both amongst whiskies in general and amongst the premium brands sold in South Africa.

[14] Limited has carried on the business of a wholesaler selling liquor (including JK) to retailers in the liquor trade since the 1970's. Prior to the conclusion of the distribution agreement in 1991, JK was imported and sold in the Republic by Limited and by a competitor, T (Pty) Ltd. The distribution agreement changed this. It entitled Limited to purchase and then to exclusively sell JK, ST and YZ in the Republic. It, however, also restricted Limited from selling any other brand of whisky in competition with JK, ST and YZ whiskies.

[15] Limited lost the exclusive right to distribute JK as a result of the conclusion of the termination agreement and was paid R67m in compensation for the loss of the right.

[16] Mr. Cilliers who appeared with Mr. Louw on behalf of Limited submitted that the amount received by Limited as compensation for the lost right was of a capital nature and took as point of departure the proposition that where payment is made by way of compensation (or, where there has been a

breach, by way of damages) upon termination of a contract or the termination of the benefits arising from a regime created by a contract, the compensation generally takes on the character of the loss for which the compensation is paid. (LAWSA 2 Ed (2009) Vol 22 Part 1 para 56 (b). Silke on South African Income Tax, 2010 Service 41, p3-51 para 3.23.) Therefore, if the payment received 'fills a hole' in the capital assets of the taxpayer, the receipt is of a capital nature. In Estate AG Bourke v CIR (1991) SATC 86 at 93 – 94 it was put as follows:

When the receipt in question represents compensation to the taxpayer, a test which is sometimes applied is to ask the question whether the compensation was designed to fill a hole in the taxpayer's profits, or whether it was intended to fill a hole in his assets. Cf Burmah Steam Ship Co Ltd v Inland Revenue Commissioners [1931] SC 156, 16 TC 67. However, as was pointed out by Broomberg Tax Strategy 2 ed (1983) at 199-200, the fact that what is plugged is a hole in assets does not, by itself, conclude the inquiry:

> 'Of course, it is not sufficient to establish that the compensation is being paid in order to fill a hole in the taxpayer's assets. It is necessary, in addition, to ascertain the true nature of asset in the recipient's hands. More particularly, was the asset, prior to its destruction or damage, an asset of a capital nature or was it floating capital? If it was floating capital, such as trading stock, standing crops or consumable stores (like petrol, oil and so forth) the compensation will, obviously, be of a revenue nature, and will be subject to tax. In

short, it is only where the payment received is to fill a hole in the capital assets of the taxpayer that the payment will escape the tax net.'

[17] As Mr. Emslie who appeared with Mr. Sholto-Douglas on behalf of the respondent pointed out, it is often the case in tax matters that it is sometimes easy to state the test and guidelines to be used, but that it can be more difficult to apply such test and guidelines to determine whether an amount is of a capital or of a revenue nature.

[18] Counsel on both sides emphasised that there is no single criterion for determining whether an accrual or receipt is of a capital or revenue nature and that each case has to be judged on its own facts and circumstances. (Estate AG Bourke v CIR and 53 SATC 86 at 93). Counsel referred us to a number of guidelines used by the courts in deciding the issue. For ease of reference I adopt the formulation set out in the heads of argument on behalf of the appellant.

1. The statement that 'income is derived from the employment of capital' whereas the proceeds derived from the 'realisation of a capital asset' constitute capital. CIR v People's Stores (Walvis Bay) 1990 (2) SA 353 (AD) at 364.
2. The distinction drawn between 'fixed capital' and 'floating capital'. The proceeds from the realisation of the former is regarded as being of a capital nature, while the proceeds of the realisation of the latter is regarded as being of an income nature. CIR v George

Forest Timber Co Ltd 1924 AD 516 Solaglass Finance Co (Pty) Ltd v CIR 1991 (2) 257 (AD); Estate AG Bourke v CIR, supra at 93 – 94.

3. The distinction between the 'means of producing income' which comprises the income producing structure; and the income producing activities themselves, the proceeds whereof comprise income. Taeuber and Corssen (Pty) Ltd v Secretary for Inland Revenue 1975 (3) SA 649 (AD); ITC 1341 (1981) 43 SATC 215; WJ Fourie Beleggings v The Commissioner for the South African Revenue Service 71 SATC 125 (SCA).

4. Whether the transaction in question amounted to the giving up or closing down of a particular branch of the taxpayer's business. ITC 1557 (1992) 55 SATC 218 at 227.

5. The metaphors used in distinguishing between 'the tree' which produces 'the fruit', and is thus part of the income-producing structure, on the one hand, and 'the fruit' itself, which comprises income produced from that structure. CF Estate AG Bourke v CIR 1991 (1) 661 (AD); 53 SATC 86 at 96.

6. Whether a substantial part of the income-producing structure had been sterilised by the transaction in question. Thus the 'chopping off' of an important 'limb of the fruit-bearing tree' has been regarded as not 'a normal incident of appellant's business', and the impairment of 20% of the appellant's business has been regarded as impairment of a material part thereof. The compensation paid for such impairment by the withdrawal of a party from a joint

venture, has been regarded as being of a capital nature in ITC 1341 (1980) 43 SATC 215.

7. Whether the proceeds in issue constitute ‘a gain made by an operation of business in carrying out a scheme for profit making’. SIR v The Trust Bank of Africa Ltd 1975 (3) SA 652; 37 SATC 87 at 101 – 102; Silke on South African Income Tax 2010 service pp3-5 to 3-6 para 3.1.

[19] Mr. Emslie submitted that it was necessary to stand back as it were and to adopt a common sense approach. In this regard he referred to the following remarks of Smalberger JA in the leading authority on the distinction between capital and revenue, Commissioner for Inland Revenue v Pick ‘n Pay Employee Share Purchase Trust 1992 (4) SA 39 (A) at 56:

> ‘There are a variety of tests for determining whether or not a particular receipt is one of a revenue or capital nature. They are laid down as guidelines – there being no single infallible test of invariable application. In this respect I agree with the following remarks of Friedman J in ITC 1450 51 SATC 70 at 76:
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> > ‘But when all is said and done, whatever guideline one chooses to follow, one should not be led to a result in one’s classification of a receipt as income or capital which is, as I had occasion previously to remark, contrary to sound commercial and good sense.’

[20] Mr. Emslie submitted that the remarks of Franklin, J in ITC 1259 39SATC 65 at 68-9 also reflect this approach:

> 'It has been stressed in numerous decisions of this nature that in each case the question is one of circumstance and degree. A lucid statement of that proposition occurs in the judgment of Birkett LJ in *Wiseburgh v Domville* [1956] All ER 754 (CA) at 759 as follows:
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> > 'In all the cases cited, the Courts have found great difficulty in laying down a precise line that could be applied to the facts of any given case. I think the most helpful passage was in Lord Russel's speech in *Inland Revenue v Fleming & Co (Machinery), Ltd* (3) 33 TC at 63:
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> > "The sum received by a commercial firm as compensation for the loss sustained by the cancellation of a trading contract or the premature cancellation of an agency agreement may in the recipient's hands be regarded either as a capital receipt or as a trading receipt forming part of the trading profit. It may be difficult to formulate a general principle by reference to which in all cases the correct decision will be arrived at since in each case the question comes to be one of circumstance and degree. When the rights and advantages surrendered on cancellation are such as to destroy or *materially* to cripple the *whole*

> structure of the recipient's profit-making apparatus, involving the serious dislocation of the normal commercial organisation and resulting perhaps in the cutting down of the staff previously required, the recipient of the compensation may properly affirm that the compensation represents the price paid for the loss or sterilisation of a capital asset and is therefore a capital and not a revenue receipt."

[21] In developing the argument that the R67m received by Limited was of a capital nature Mr. Cilliers submitted that the evidence established that the right to exclusively sell JK whisky in the Republic was an important part of the income producing structure of the business conducted by Limited. Mr. Y testified that the sale of JK whisky represented about 25% of Limited's bottom line and according to Whitehead's more detailed calculation, JK whisky sales contributed between 18% and 24% of Limited's net profit. Limited had been instrumental in building up the JK brand in the Republic over many years prior to the conclusion of the distribution agreement. According to Mr. O, JK had become a Known Value Item (a KVI) which is a valuable line to the retailer because it 'brought feet into the store'. The exclusive right to distribute JK therefore gave Limited powerful leverage and put it in a strong bargaining position when negotiating the placement of its other products in retail stores. Limited could demand 'forward space' for its products at the expense of the products of its competitors. The JK brand which had been built up in South Africa by Limited was, Mr. Cilliers suggested, in effect the 'tree' which would produce 'fruits' for decades. JK has continued to hold its position in the

market. Mr. O testified that in his experience JK has since the conclusion of the termination agreement continued to remain number one among whiskies generally and among the proprietary brands in South Africa and that it continues to confer great bargaining power on Gilbeys, its current distributor. There were further advantages to Limited as the holder of the exclusive right to sell JK in South Africa. While generally distribution agreements with other international companies involved the local manufacture or bottling of overseas brands, JK was imported in bottled form. This allowed Limited to adjust its purchases to demand and to avoid having to build up an inventory. It enabled Limited to save on maturation and storage costs. Because of its importance in Limited's business and because the distribution agreement contained a non compete clause and Limited was not entitled to and did not market and distribute other whiskies, the JK brand was afforded special treatment by Limited, amounting, in effect to it being dealt with internally as if it were a separate division or structure in the business of Limited, dedicated to the sale and distribution of JK. A brand manager was appointed for JK and brand 'ambassadors' were used in its marketing. More than one advertising agency was used for JK and special merchandising was used to market the JK brand. It was the only product to be marketed in the upmarket association of the game of golf. Mr. Y explained that although the agreement was for an initial period of eleven years (ten years plus one notice year), the reasonable expectation at the time was that Limited would continue to be entitled to sell JK and that the agreement would be extended, possibly indefinitely, provided Limited continued to handle the brand effectively and to the satisfaction of F Co. Over the period the agreement did run, the distribution rights to the JK

brand became an asset of increasing value to Limited, Mr. Cilliers submitted. The importance of the JK brand and the exclusive right to distribute the product to Limited's business is illustrated graphically by what happened after the termination of the exclusive distribution right. The impact on income and profits, was, according to Whitehead, 'enormous'. Mr. Y characterised the impact on Limited's operating income as 'disastrous'. Although there had already been a dip in the general market, Limited's trading income dropped substantially and dramatically by approximately 30% from R131 290 730 in the 1998 financial year to R92 758 395 in the 1999 financial year and by a further almost 20% to R74 647 632 in the 2000 financial year. Although there may have been other factors at work, on the evidence of Whitehead, the loss of the exclusive distribution right was the only known factor. In addition to the loss in trading income, Limited lost the bargaining power it had with retailers because it had lost the right to exclusively distribute the powerful JK brand. Limited was free to substitute the JK products with competing brands, but was not able to do so. Not only did the loss of the exclusive distribution rights result in loss of market share and trading income, it also resulted in what Mr. Cilliers submitted amounted to structural changes to Limited's business. The evidence was that Limited could not replace the rights flowing from the distribution agreement which involved reciprocal exclusivity, by the conclusion of a similar distribution agreement. Limited tried, but failed to obtain exclusive distribution rights to other proprietary whiskies. It then attempted to mitigate the loss with the distribution rights it obtained for the cut price whisky, WX Whiskey. The loss of trading income after the loss of the distribution rights to JK was permanent. Mr. Y graphically described how the loss of the exclusive

right led to what Mr. Cilliers termed the ultimate structural change, namely, the decision made two years later for Limited to merge with LC Corporation in 2001. Mr. Y testified that he saw no other option, except the eventual bankruptcy of Limited. It could not survive without the right to exclusively sell JK, its most profitable spirit.

[22] The 1997 merger between MM plc and GF plc was a fact beyond the control of Limited. One of the repercussion of the merger was that Limited had no option but to compromise and accept an early cash payment for the inevitable termination of the distribution agreement which was bound to happen at the end of the eleven year period which would arrive 41 months later.

[23] Mr. Cilliers submitted that all these facts clearly demonstrate that the loss of the exclusive distribution right was the loss of an asset and that the loss was of a capital nature. A large ‘hole’ was created in Limited’s business structure and the R67m paid by F CO. served to fill that ‘hole’. The payment was therefore of a capital nature and not susceptible to tax, he submitted.

[24] The loss of the JK distribution rights resulted in insignificant changes to Limited physical business infrastructure. But a few personnel (three to four out of 3200 employees) were laid off. JK was fully imported in bottled form and the litreage of the JK products sold amounted to only 1.45% of the total litreage handled by Limited. Limited’s infrastructure regarding production and distribution therefore remained virtually intact.

[25] The position was therefore that although Limited's income-earning infrastructure remained virtually unaffected, Limited could no longer distribute and sell, through its income-earning structure, the JK brand of products over the remaining period of the distribution right. Its existing income-earning structure was rendered less profitable, but it remained virtually unchanged and was not removed.

[26] Although Limited over the years contributed to the build up of the JK, YZ and ST Brands in South Africa, the brands were not owned by Limited. The brands were assets owned by F Co. Limited merely had the exclusive use of the brands in South Africa for the duration of the distribution agreement.

[27] The rights derived from the distribution agreement did not in itself constitute part of the business carried on by Limited. Limited did not trade in the purchase and sale of rights to purchase and sell (exclusively, or otherwise) whisky. The distribution right was not trading stock in the hands of Limited and Limited could in terms of the distribution agreement, in any event, not dispose of the right.

[28] The individual purchases of JK whisky from F Co. and the sales of the whisky to the retail trade constituted an important and lucrative part of the business activities of Limited. The exclusive right enabled Limited to sell a popular brand of whisky for as long as the right endured. It rendered the

wholesale business of Limited, lucrative and yielded income and profit to Limited.

[29] The nature of the exclusive right Limited derived from the distribution agreement to sell JK in South Africa is common cause. Mr. Cilliers submitted that it was a capital asset and Mr. Emslie, on behalf of the respondent conceded that it was a capital asset in the hands of Limited.

[30] I agree that one of Limited's capital assets was the exclusive distribution right. Non constat, however, that the R67m paid was of a capital nature. The question is whether Limited was compensated for the capital value of this right, i.e. whether the compensation of R 67m paid for the early termination of the distribution right was paid as compensation for the loss of the value of the capital asset, the distribution right and therefore, to fill a hole in Limited's assets, or whether it was paid as compensation for a loss of profit on the sale of the JK whiskies which would be the result of the early termination of the distribution right. In order to determine the nature of the amount paid to Limited for the early termination of the exclusive distribution right, it is important to look at the bargaining position of Limited and what the amount was to be paid for, at the time the parties were negotiating and agreeing the terms upon which the right would be terminated. At the time of the negotiations it was clear that whatever Limited's reasonable expectations as to the duration of the right might have been before the merger of the two liquor wholesalers in the UK, and that, whatever the outcome of the negotiations, the right would not endure beyond the remaining 41 months and

that that period was the full extent of the remaining life of the distribution right. The right could only be extended with the agreement of F Co, who had already firmly indicated that it did not intend to extend its life beyond the remaining 41 months. The parties were therefore negotiating on and ultimately agreed upon the compensation for a wasting asset with a finite lifespan.

[31] Mr. Cilliers submitted that it is significant that the negotiations between the parties culminated in the payment of R67m which amounts to more than 50% more than the net present value of the projected after tax income that Limited would have earned on the sale of JK whisky during the unexpired period of 41 months that the distribution agreement would otherwise have endured. The starting point in Limited's calculations in preparing for the negotiations is explained in evidence in chief by Mr. X, who testified on behalf of Limited to the value of the distribution right, as follows:

> 'My Lord I was asked to negotiate on behalf of SFW Limited an amount for the termination of this contract as it had a period to run and we clearly needed to be compensated for that if it was terminated early.'

This statement by Mr. X must be seen in the context of Limited's internal document at bundle 1: 120, which shows that when Limited's side to the negotiations calculated what they would put forward, their starting point was a calculation of Limited's loss of profits over the remaining 41 months from the sale of JK, ST and YZ whiskies as well as the profits from other products

associated with the sale of the three JK whiskies. The final agreed compensation of R67m mirrors this. It was made up of R42 117.00 which compensated Limited for the projected loss of profit for the remaining 41 months. The rest of the R67m was made up as compensation for the loss of profit from other products which Limited would have been able to 'bundle' with or 'piggy-back' on the sales of JK and R7m, which was expressly attributed to the risk that income tax would be payable.

[32] While the method of calculation of the amount of compensation is an important factor, it is not determinative of the nature of the receipt. This is so because:

> '[I]t is a normal principle of valuation of a capital asset, whether it be land or the goodwill of a business or otherwise, to use the profits expected to be earned from the utilisation of the asset as a basis or starting point for the relevant calculations' per McEwan J in ITC 1341 (1980) 43 SATC 215 at 224; and see Taeuber and Corssen (Pty) Ltd v CIR (1975) 37 SATC 129 at 140; and see CIR v Illovo Sugar Estates Ltd (1950) 17 SATC 387 at 394.

[33] In addition to the method of calculation, there are a number of other indicators of how Limited, at the time, saw and treated the amount of R67m it received.

[34] Limited's financial statements show that in the 1999 financial year, the year the R67m was received, Limited reflected the R67m as an exceptional item under 'cash flow from operating activities' and not 'cash flow from investing activities' and that it declared a dividend of some R88m. In tandem with this, the termination agreement itself provided that the R67m was to be paid into ABC Group's dividend account. Mr. X conceded in cross examination that Limited would not have been able to pay the dividend of R88m had it not received the compensation of R67m. Although Mr. X in re-examination agreed with the statement that because of Limited's reserves of some R572m at the end of the 1999, it would have been able to pay the dividend, the fact is that Limited's balance sheet discloses that of the said reserves of R572m, some R568m were not represented by cash and were invested in inventories such as bulk and bottled wines, fruit beverages and spirits and packaging, production and other materials. This accords with the evidence of Whitehead who stated that there were very little cash savings in Limited.

[35] In Limited's statement of its grounds of appeal the following is said about Limited's view at the time of the negotiations leading up to the conclusion of the dissolution agreement:

> "It was commercially more sensible for the Appellant to have the distribution agreement terminated in 1998, upon payment of compensation for the termination of its rights, than to have the agreement run its full term and then not have it renewed. If it became

apparent, in 1998, that the Appellant's rights to distribute JK and YZ whisky would not have been renewed in January 2002, this would have had a serious detrimental effect on the motivation of sales staff, leading to a reduction in income. Furthermore, the Appellant had to give itself time to attempt to limit the damage that would have been caused by the loss of its distribution rights by attempting to garner other business in the place of the lost products."

[36] It is clear in my view from this statement that Limited anticipated a reduction in profit from the sale of JK if the distribution right was simply to be allowed to wind itself down over the remaining 41 months. It was therefore commercially more sensible for Limited to negotiate for an early termination of the right, sooner than later, at greater compensation for its profits which it expected to shrink as the inevitable end of the right came nearer in time.

[37] On appeal, Limited bears the onus in terms of sec 82 of the Act to prove that the amount of R67m was received not as compensation for the loss of future profits, but as compensation to fill a hole in its income-earning structure.

[38] In my view, Limited has not discharged this onus. The evidence establishes that the amount of R67m, although it was paid for the early demise of an asset, the distribution right, it was not calculated on the basis of the capital value of the waning asset which was due to terminate in 41 months. Mr. X, who testified on behalf of Limited agreed that an arms length

purchaser, if it could have purchased the distribution right, would not have paid an amount equal to the future profits, including profits from other products that could be piggy-backed on the sales of JK because such a purchaser would then not have had any prospect of itself making a profit. A notional purchaser would probably not have paid even R42, 177m (the net future profits from the sale of JK) and far less, the R67m actually paid by F CO.. The amount paid was not related to the value of the right to distribute JK for a further 41 months. The amount paid was a figure principally based on Limited's loss of future profits from the sale of JK and the other products. The amount paid sought to 'fill a hole' in Limited's profits.

[39] It follows that in my view the respondent correctly determined that the amount of R67m was of a revenue nature.

[41] The second issue on appeal is whether the respondent was correct in declining to waive interest in terms of section 89 quat (3) of the Act. The respondent did so on the basis that Limited had not on reasonable grounds contended that the amount of R67m should not have been included in its taxable income. Mr. Cilliers submitted that this court should in terms of section 89 quat (5) substitute its own decision in this regard and order the waiver of the interest. First, he submitted, this is a difficult case and Limited's contentions were reasonable, albeit unsuccessful. Secondly, Limited was furnished with an opinion of reputable solicitors and tax consultants that neither income tax nor VAT was payable on the receipt. Limited therefore

disclosed the receipt openly and contended that the R67m should not be included in its gross income.

[40] I agree with Mr. Cilliers that in the circumstances of this case, Limited had reasonable grounds for its contention. To illustrate this point the position of Limited may be contrasted with that of the taxpayer in WJ Fourie Beleggings v C: SARS 71 SATC 125 (SCA). In that case the taxpayer, who traded as an hotelier, had concluded a lucrative contract with the company Naschem to provide accommodation to a number of persons for a period of 25 months. After the contract had run for a number of months, Naschem repudiated the contract and pursuant to settlement negotiations, Naschem paid the taxpayer R1,3m in settlement of all claims the taxpayer might have arising from the early termination of the contract. The SCA held on appeal that the R1.3m paid to the taxpayer was not of a capital nature and that it must be regarded as part of the taxpayer's gross income. The contract with Naschem did not constitute the means by which the taxpayer generated business, acquired business or obtained opportunities from which to earn an income. It was not an asset of a capital nature forming part of the tax payer's income – producing structure. The contract with Naschem was 'merely the memorial of business the (taxpayer) had concluded, in which the number of persons it had agreed to accommodate, when that would take place and the rate that would be charged, were recorded.' (at 132 CD). In this case, Limited was compensated for the loss of an asset, the distribution right, which rendered its business very lucrative. Nevertheless, the compensation paid, although paid for the loss of an asset, was of a revenue nature and not a

capital nature. In my view, the link between the compensation of R67m and the reduction in the profits of Limited to be brought about by the termination of the distribution agreement, was not so close or obvious as to render the grounds for Limited's contentions unreasonable.

[41] It follows that in my view, the appeal must be turned down on the issue of the nature of the compensation, but must succeed on the issue of interest on the compensation.

[42] The following order is consequently made:

1. The appeal against the inclusion of the amount of R67m as part of the appellant's gross income in the assessment for the 1999 tax year is dismissed and the assessment is confirmed.
2. The appeal against the refusal of the respondent to direct in terms of section 89 quat (3) that interest shall not be paid on the amount of R67m, succeeds and it is directed that the appellant shall not pay interest on the amount of R67m.

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W.J. Louw
JF Co.ge of the Western Cape Tax Court

I agree. _________________________

Assessor: Mr. P. Ranchhod

I agree.

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Assessor: Mr. B. Nduna