REPUBLIC OF SOUTH AFRICA

IN THE TAX COURT OF SOUTH AFRICA
(HELD AT CAPE TOWN)

CASE NO.: **IT 45638**

Before: The Hon. Mr Justice Binns-Ward (President)
Adjunct Assoc. Prof. D. Warneke (Accountant member)
Adv. M. Titus (Business member)

Hearing: 29 and 31 May 2023
Judgment: 19 July 2023

In the matter between:

A TAXPAYER **APPELLANT**

and

THE COMMISSIONER FOR **RESPONDENT**
THE SOUTH AFRICAN REVENUE SERVICE

J U D G M E N T

(Edited version for compliance with section 132 of Act 28 of 2011)

BINNS-WARD J

Introduction

[1] The taxpayer is a member of a group of companies that carries on business in the production, export and marketing of fresh fruit products, including table grapes. It fulfils a marketing role in the group's business activities. In the main, the company's business is to act as a marketing agent for third party fruit producers, including some fruit producing companies within the group. Its income in that capacity is derived from commissions. The taxpayer does, however, to a very limited extent, also sometimes purchase fruit from local producers to sell for its own account on the export market.

[2] The matter before the court is an appeal in terms of section 107 of the Tax Administration Act 28 of 2011 by the taxpayer against the decisions by the Commissioner for the South African Revenue Service (i) to disallow as a deduction in terms of section 11(*a*) (read with section 23(*g*)) of the Income Tax Act 58 of 1962[1] the amount of R15 320 263 that was expended by the taxpayer during the 2016 tax year by way of a grant made to Newco (Pty) Ltd, (ii) consequentially, to impose a penalty in the amount of R730 532.32 in terms of paragraph 20(1) of the Fourth Schedule to the Act for underpayment of provisional tax as a result of an underestimation by the taxpayer of its taxable income in respect of the 2016 tax year, alternatively, in the event that the deduction was rightly disallowed, failing to remit the penalty in whole or in part, as provided for in paragraph 20(2) of the said Schedule[2] and (iii) not

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[1] Section 11(*a*) of the Income Tax Act provides: "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—

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

and section 23(*g*) provides: "No deductions shall in any case be made in respect of the following matters, namely—

> (*g*) any moneys claimed as a deduction from income derived from trade, to the extent to which such moneys were not laid out or expended for the purposes of trade."

Section 11*(a)* provides positively for what may, and section 23 negatively for what may not, be deducted in the determination of a taxpayer's taxable income; a deduction claimed must satisfy both sections. See *Commissioner for Inland Revenue v Nemojim (Pty) Ltd* 1983 (4) SA 935 (A) at 946 – 7, *Solaglass Finance Co (Pty) Ltd v Commissioner for Inland Revenue* 1991 (2) SA 257 (A) at 269*fin*.

[2] Paragraph 20(1) of the Fourth Schedule to the Income Tax Act provides for the imposition of prescribed penalties for the underpayment by a taxpayer of provisional tax as a result of an underestimation of its taxable income by the taxpayer in its provisional returns. Paragraph 20(2) of the Schedule provides: "Where the Commissioner is satisfied that the amount of any estimate referred to in subparagraph (1) was seriously calculated with due regard to the factors having a bearing thereon and was not deliberately or negligently understated, or if the Commissioner is partly so satisfied, the Commissioner may in his or her discretion remit the penalty or a part thereof". Section 220 of the Tax Administration Act provides: "A decision by SARS not to remit a 'penalty' in whole or in part is subject to objection and appeal under Chapter 9."
Chapter 9 is the chapter in which section 107 resorts.

to waive, in terms of section 89*quat*(3) of the Income Tax Act,[3] interest on the unpaid normal tax determined in the additional assessment in which the aforementioned deduction was disallowed.

[3] The Commissioner disallowed the deduction claimed by the taxpayer, inter alia, because he considered the expenditure concerned to be of a capital nature. The second and third of the aforementioned three questions in the appeal call for determination only if the Commissioner's decision in respect of the first question (ie the deductibility of the taxpayer's grant payment to Newco) is confirmed.

[4] This judgment reflects the unanimous findings of the court.

The character of the taxpayer's expenditure in respect of the grant made to Newco (Pty) Ltd

[5] It should be apparent from what has been said thus far that the pivotal question in this appeal is whether the taxpayer's expenditure on the grant to Newco is properly characterised as being revenue or capital in nature. We understood it not to be in issue by the end of counsel's oral argument in the appeal that (i) the expenditure was incurred, (ii) in the production of income and (iii) laid out for the purposes of trade.[4]

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[3] Section 89*quat*(3) of the Income Tax Act provides: "Where the Commissioner having regard to the circumstances of the case is satisfied that the interest payable in terms of subsection (2) is a result of circumstances beyond the control of the taxpayer, the Commissioner may direct that interest shall not be paid in whole or in part by the taxpayer." Subsection (2) provides for the payment of interest by a taxpayer on the amount by which its provisional tax payments for the tax year in question were less than its assessed normal tax liability for that year. Such interest is calculated from the "effective date" – as defined in subsection (1) – in relation to the said year until the date of assessment of such normal tax. Any decision of the Commissioner in the exercise of his discretion under sub-section 89*quat*(3) is subject to objection and appeal by virtue of sub-section 89*quat*(5).

[4] Cf. e.g. *Warner Lambert SA (Pty) Ltd v Commissioner, South African Revenue Service* 2003 (5) SA 344 (SCA), paragraph 7. The positions initially adopted by the Commissioner that the outlay was a loan and/or that it was not in the production of income because there was no quid pro quo for the expenditure were either abandoned or not pressed in argument.

[6] The Income Tax Act does not define the difference between revenue and capital expenditure, and it has been remarked in countless judgments that drawing the distinction is often a difficult undertaking.[5] Various pointers that assist in the characterisation exercise have been identified in the jurisprudence, some of which will be mentioned later in this judgment, but it has long been appreciated that none of them is of itself decisive or necessarily pertinent. In each case determining the character of the expenditure has to be done with close regard to the facts peculiar to the outlay under consideration.[6] The burden of proof in establishing that the expenditure in question was deductible was on the taxpayer; see section 102 of the Tax Administration Act.

[7] The grant payments to Newco were made pursuant to a tripartite agreement concluded in 2014 between the taxpayer of the one part, ABC Sustainable Trade Initiative of the second part and XYZ of the third part. ABC is a foundation established under the laws of [a foreign country] and registered with the Chamber of Commerce [in that country]. It was running a programme known as the "Sustainability Initiative ***" directed at "accelerating and upscaling viable and sustainable fruit and vegetable production and trade" universally. XYZ is a prominent [European] retail business with which the taxpayer and the group of companies of which it is part had, and still have, an established commercial relationship. XYZ purchases a

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5 In *Commissioners of Inland Revenue v. British Salmson Aero Engines Ltd.* [1938] 2 K.B. 482, at 498, Sir Wilfrid Greene MR ventured that "There have been many cases which fall on the borderline. Indeed, in many cases it is almost true to say that the spin of a coin would decide the matter almost as satisfactorily as an attempt to find reasons". Lord Upjohn remarked of that observation "Somewhat cynical, but true. It is a question of fact and degree and above all judicial common sense in all the circumstances of the case, and, while no one regrets it more than I, I do not believe it is possible to lay down any principle, when dealing with trading contracts, which would be of any guidance alike to Crown and subject in future cases."; *Regent Oil Co Ltd v Strick (Inspector of Taxes); Regent Oil Co Ltd v Inland Revenue Commissioners* [1965] 3 All ER 174 (HL), 43 T.C. 1 at 53A (T.C.). The judgments in *Regent* (in the High Court, Court of Appeal and House of Lords) are also accessible at **https://www.bailii.org/uk/cases/UKHL/1965/TC_43_1.pdf**.

6 In *Regent* supra, at 29D-F (T.C.), Lord Reid remarked in this regard: "*Whether a particular outlay by a trader can be set against income or must be regarded as a capital outlay has proved to be a difficult question. It may be possible to reconcile all the decisions, but it is certainly not possible to reconcile all the reasons given for them. I think that much of the difficulty has arisen from taking too literally general statements made in earlier cases and seeking to apply them to a different kind of case which their authors almost certainly did not have in mind— in seeking to treat expressions of judicial opinion as if they were words in an Act of Parliament. And a further source of difficulty has been a tendency in some cases to treat some one criterion as paramount and to press it to its logical conclusion without proper regard to other factors in the case. The true view appears to me to be that stated by Lord Macmillan in Van den Berghs Ltd. v. Clark (1) [1935] A.C. 431, at page 438:*

> *'While each case is found to turn upon its own facts, and no infallible criterion emerges, nevertheless the decisions are useful as illustrations and as affording indications of the kind of considerations which may relevantly be borne in mind in approaching the problem.'* "

Similar sentiments were expressed by Marais JA in *Rand Mines (Mining & Services) Ltd v Commissioner for Inland Revenue* 1997 (1) SA 427 (A) at 433H-434C; see also *Sub-Nigel Ltd v Commissioner for Inland Revenue*, 1948 (4) SA 580 (A) at 595 and *Commissioner for Inland Revenue v African Oxygen Ltd* 1963 (1) SA 681 (A) at 690*fin*-691D.

significant portion of the grapes exported annually by the taxpayer for sale to the customers at its supermarkets in [Europe].

[8] It would appear that the taxpayer's involvement in the tripartite agreement happened on the initiative of XYZ. The evidence suggests that XYZ assessed that it might enjoy a domestic marketing advantage through being able to offer to its customers produce generated from sources associated with environmental sustainability and social upliftment.[7] XYZ identified that its customers would be willing to pay a premium on the price of grapes sourced from such producers and that it would be able to recover any outlay on its part in funding production in terms of environmental sustainability and social upliftment initiatives by modestly increasing the prices charged to its customers.

[9] XYZ identified the group of companies of which the taxpayer is part as a viable partner in the contemplated initiative because it was aware of the group's involvement in socio-economic upliftment. At the time, a substantial shareholding in one of the group companies, Newco, was held by a trust established for the benefit and socio-economic upliftment of a number of previously disadvantaged current and former female employees of the group. The trust had 49 such beneficiaries at the time the tripartite agreement was concluded. The trust holds 40 per cent of the issued shares in Newco, with the remaining 60 per cent being held by T Holdings (Pty) Ltd, of which the taxpayer is a wholly owned subsidiary in the group structure.

[10] XYZ was also conscious, by virtue of its established commercial relationship with the group, of its high standards and reliability. In other words, XYZ regarded the group, including the taxpayer, as a dependable source of supply when it identified it as a worthy participant in the funding venture.

[11] Newco was engaged in the production of grapes for the export market on 100 hectares of land on the [***] River in the [***] Province. The object of the tripartite agreement was to fund the expansion of Newco's cultivation of export grapes from 100 hectares to 150 hectares of vineyards. It was envisaged that the additional hectarage could yield up to 350 000 cartons of grapes per year and potentially provide a significant boost to the taxpayer's marketing throughput of about 5,5 million cartons to the global market annually. It was contemplated that the proposed expansion would be associated with the provision of skills education to the local population and an increase in the number of beneficiaries of the shareholding trust by at least 25 women. The benefit foreseen by XYZ from the arrangement was the securing of an increased and dependable supply of grapes for sale in its supermarkets. The contemplated arrangement would also tie in Newco, as a component of a well-established group of fruit

[7] XYZ's application to ABC recorded that "As supply chains become more transparent and the relationship between retailer and producer more direct, there is an increasing pressure to improve environmental and social standards in production to satisfy the expectations of the consumer."

production and marketing companies, with the taxpayer as the so-called "implementing partner" in terms of the tripartite agreement. The taxpayer's obligations as the implementing partner under the agreement included ensuring the efficient management of grape production by Newco and the maintenance of quality control to the required standards. It is evident from those parts of the agreement that were produced in evidence that its implementation would also include the application of the grant for the financing of machinery such as tractors and sprayers and the erection of buildings for housing, pack housing and storage.

[12] XYZ applied to ABC for assistance in funding the project. The uncontested evidence was that ABC's involvement in funding the project was a purely philanthropic measure directed at the implementation of its abovementioned Sustainability Initiative.

[13] XYZ proposed the idea to the group in South Africa. The evidence was to the effect that XYZ did not place the group under any pressure to enter into the arrangement. The funding arrangement subsequently incorporated in the tripartite agreement was that a stipulated amount denominated in euros (then equating to approximately R50 million) would be paid to Newco on a non-refundable basis over the term of the agreement. XYZ and ABC would, between them, provide 40 per cent of the funds and the taxpayer the remaining 60 per cent. It is noteworthy that the taxpayer's contribution corresponded directly, percentagewise, with its parent company's holding in Newco, and the combined contribution of the foreign funding providers corresponded with the trust's holding.

[14] The taxpayer's holding company, which it will be recalled was also the majority shareholder in Newco, sought professional advice on the tax implications of funding the proposed project. It seems clear from the tax advisers' description of their mandate in the written opinion, a copy of which was produced in evidence at the appeal, that there was no clear idea at the conceptual stage as to which entity in the group should be the funding party. The opinion recapitulated the import of the advisers' mandate as follows: "You have requested our opinion in respect of a proposed transaction in terms whereof European entities and a company associated with the [T] Group of Companies will advance funds by way of a grant to Newco." The opinion continued "The choice of the [group] entity to advance the funding (i.e. the grant) will in our opinion be important as it could impact on the tax consequences."

[15] The tax advisers proposed that the taxpayer "be the [group] entity to advance the grant". They motivated their proposal by saying that the taxpayer "… is involved in the business of marketing and exporting the fresh fruit products from SA to the various overseas markets. In order for its business to operate successfully [the taxpayer] needs to satisfy the requirements of its overseas customers in respect of their need for fresh fruit products with access to products. The granting of funds by [the taxpayer] to Newco will enable Newco to increase its production capabilities. The grant will therefore in our opinion be closely aligned

with the business operations of [the taxpayer] and therefore in the production of income and for the purposes of its trade." The advisers counselled against choosing the taxpayer's holding company or another company in the group that conducted farming operations on a number of farms owned by the group as the funding entity because the expenditure could not be characterised as having been incurred for the purposes of trade by either of those companies.

[16] The tax advisers opined (and this is not contentious) that the grant would not incur a liability by the taxpayer for donations tax as the funding would not be provided out of "sheer liberality" or "disinterested benevolence".[8] Addressing the question whether the taxpayer would be able to deduct its expenditure on the grants in terms of section 11(*a*) of the Income Tax Act, the advisers expressed the view that the funding would be "no more than part of the costs incidental to the performance of the income earning operations of [the taxpayer's] business (i.e. marketing and distribution) and therefore a revenue nature expense. The contributions would not result in the creation or acquisition of any new source of profit nor is there any enduring benefit created as a result of the grant."[9]

[17] Referring to the full court's judgment in *Commissioner for Inland Revenue v VRD Investments (Pty) Ltd* 1993 (4) SA 330 (C), 55 SATC 368, the tax advisers argued that the grants "would ultimately be intended to assist [the taxpayer] in its income producing operations and thereby making the business of [the taxpayer] more profitable". They considered that as the expenditure would not result in the taxpayer acquiring a permanent asset or right, or change its "income earning structure", it would not be of a capital nature.[10]

[18] According to its tenor, the tripartite agreement was conditional upon approval by three parties that were not directly privy to the contract, viz. Newco, "T Group" (apparently, the taxpayer's holding company), and the trustees and beneficiaries of the aforementioned women workers' trust.

[19] The taxpayer's obligations as implementing partner under the tripartite agreement included the "implementation and coordination" of the project to expand the area of Newco's cultivated production and "management", including overseeing the application of the funds provided by it, ABC and XYZ. The agreement recorded that XYZ foresaw "prognosticated"

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8 Expenditure motivated by considerations of sheer liberality would in any event not qualify as expenditure in the production of income or for the purposes of trade.

9 Statements plainly predicated on the passage in *New State Areas Ltd v Commissioner for Inland Revenue* 1946 AD 610, 14 SATC 155 quoted in paragraph [19] below.

10 Contra *Secretary for Inland Revenue v Cadac Engineering Works (Pty) Ltd* 1965 (2) SA 511 (A) at 522*fin* – 523, where Ogilvie Thompson JA observed "…the mere circumstance that a payment has neither created a new asset nor made any addition to an existing asset is not necessarily conclusive in favour of such payment being a revenue expense".

sales of 10,5 million punnets of grapes from the group during the project period.[11] The application by XYZ to ABC recorded as one of the objects of the project "the production in sales to XYZ", the first of such sales being "expected after 24 months". The evidence was to the effect that newly planted vines might be expected to be productive two years after planting. We understood from the evidence that the established mode by which XYZ imported grapes from South Africa when the project was conceived and agreed upon was through the agency of the taxpayer.

[20] In *New State Areas Ltd v Commissioner for Inland Revenue* 1946 AD 610, 14 SATC 155, it was held (at p.627 (AD)) that:

> "…the true nature of each transaction must be enquired into in order to determine whether the expenditure attached to it is capital or revenue expenditure. Its true nature is a matter of fact and the purpose of the expenditure is an important factor; if it is incurred for the purpose of acquiring a capital asset for the business it is capital expenditure even if it is paid in annual instalments; if, on the other hand if it is in truth no more than part of the cost incidental to the performance of the income producing operations, as distinguished from the equipment of the income producing machine, then it is a revenue expenditure even if it is paid in a lump sum."

[21] In *Commissioner for Inland Revenue v George Forest Timber Co Ltd* 1924 AD 516, 1 SATC 20, it was held by Innes CJ that:

> "Money spent in creating or acquiring an income-producing concern must be capital expenditure. It was invested to yield future profit and while the outlay did not recur, the income did. There was a great difference between money spent in creating or acquiring a source of profit, and money spent in working it. The one was capital expenditure, the other was not."

Those observations were echoed in the speech of Lord Morris of Borth-y-Gest in *Regent* supra (note 5).[12]

[22] In some cases, the court has looked to whether the expenditure concerned created an "enduring benefit", by which is meant that the expenditure is made with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, which would be indicative of capital expenditure; see, for example, *Secretary for Inland Revenue v African Oxygen Ltd* 1963 (1) SA 681 (A), 25 SATC 67, at 686D-G and 688H-689E (SALR). In yet other cases, the court has had regard to whether the expenditure was incurred on a "once and for all" – as distinct from a recurring-basis, which would also be indicative of it being of a capital

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[11] According to a paper by R Smit, N.F. Treurnicht and M.M. Blanckenberg entitled '*Economic Requirements Analysis for Table Grape Check Weighing*' delivered at the ISEM 2011 Proceedings in Stellenbosch in September 2011 at §2.2 s.v. '*Packing Technology*' "[o]n average 10 [500gm] punnets fit into a carton". The evidence in the current matter suggested that the taxpayer exported approximately 4,5kg of grapes per carton, which would translate to 9x500gm punnets per carton.

[12] At 43 T.C. 41*fin*.

character. In *British Insulated and Helsby Cables Ltd. v. Atherton* [1926] A.C. 205, 10 T.C. 155. at 192 (T.C.),[13] Viscount Cave LC famously stated "…when an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, I think that there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital." See also *Vallambrosa Rubber Co Ltd v Farmer (Surveyor of Taxes)* [1910] 5 TC 529, [1910] ScotLR 488 (16 March 1910).[14]

[23] In *Commissioner, South African Revenue Service v BP South Africa (Pty) Ltd* 2006 (5) SA 559 (SCA) at paragraph 25, Streicher JA endorsed Lord Morris's approval in *Regent* supra (note 5) of the following statement by Lord Denning MR in the Court of Appeal in that matter: "The company makes a payment once and for all. In return, they get an advantage which is of enduring benefit to the company. It brings in revenue to the company week after week, and month after month, from the petrol they supply to the retailer. I have no doubt this advantage is a capital asset and the payment for it is capital expenditure." Both *Regent* and *CSARS v BP* involved lump sum payments (admittedly in quite different factual circumstances from those obtaining in the current case) by the respective taxpayers to third parties to secure or enhance their incomes that were held by the courts to be of a capital nature.

[24] Another exercise that it has been suggested might usefully be undertaken to determine whether expenditure should be treated as capital or revenue in nature is to inquire whether allowing it as a debit against income (thereby treating it as revenue in character) would have an unnaturally distorting effect on the taxpayer's profit for the year. The appeal court referred to this test with apparent approval in *CSARS v BP* supra, acknowledging its source in Lord Reid's speech in *Regent* supra (at 31G-32C (T.C.)). The examples postulated by Lord Reid would overlook the distorting effect if the transactional context provided for its correction within the following one or two succeeding years, but otherwise if the distorted result was an abiding feature related to the enduring advantage that the causative payment had been directed at achieving. This seems to us to be, in essence, just another way of expressing the "once and for all" expenditure for "enduring benefit" analysis.

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[13] Also accessible at **https://www.bailii.org/uk/cases/UKHL/1925/TC_10_155.pdf**.

[14] Also accessible at **https://www.bailii.org/scot/cases/ScotCS/1910/47SLR0488.html**. The statement by Lord Dunedin in *Vallambrosa* to which reference has often been made in the capital versus revenue debates was "Now I do not say that this consideration is absolutely final or determinative, but in a rough way I think it is not a bad criterion of what is capital expenditure, as against what is income expenditure, to say that capital expenditure is a thing that is going to be spent once and for all, and income expenditure is a thing that is going to recur every year"*;* at p.492 of the Scottish Law Reports.

[25] The fact that the expenditure was applied in the improvement of another company's land and did not result in the taxpayer obtaining ownership of a tangible asset does not preclude its characterisation as capital in nature; cf. *Commissioner for Inland Revenue v Myerson; Commissioner for Inland Revenue v Kelly* 1947 (2) SA 1243 (A) at 1251-1252 and *Palabora Mining Co Ltd v Secretary for Inland Revenue* 1973 (3) SA 819 (A) at 833G-H. In *Ounsworth v. Vickers* [1915] 3 K.B. 267, 6 T.C. 671, expenditure incurred by a shipbuilding firm in deepening a channel and creating a deep water berth on property it did not own in order to enable vessels constructed by the firm to put out to sea was held to be capital in nature.

[26] It is relevant in our view to have regard to the taxpayer's grant payments of more than R15 million to Newco in each of the 2015 and 2016 tax years in the overall context of the company's financial situation. In the taxpayer's 2015 year of assessment, the contribution of R15 759 371 was more than double the company's net profit before tax, and amounted to around 20 per cent of its total assets of R*** at year end. In the 2016 year of assessment, the contribution of R15 320 263 was greater than the company's net profit before tax of R***, and amounted to around 13 per cent of its total assets of R*** at year end. There is nothing to suggest that these relative percentages were inflated due to any trading difficulties being experienced by the company at the time that could have meant that the taxpayer's net income and/or its asset base was relatively low.

[27] The quantum of the contributions, seen in proportion to the taxpayer's asset base as well as its net income, would not have made commercial sense for the taxpayer had there been a mere hope, rather than an effective reality, that it would be assured on an ongoing basis of getting the marketing business to be generated from Newco's increased production. The group's chief operating officer, who testified for the taxpayer in support of the appeal, confirmed in evidence that the taxpayer's board was comfortable that it would in practice have access to the additional volumes of fruit produced in the expanded vineyards. She sought to emphasise that the absence of a long-term contract between the companies meant that there was nevertheless no guarantee the taxpayer's expectation would be realised. From a common sense commercial perspective, however, it is inconceivable that the taxpayer would incur expenditure on the scale just described in the mere hope, rather than expectation, that the contribution would provide it with fruit products in the future, thereby generating a substantial source of additional income for it for an indefinite period into the future.

[28] The contextually identifiable object of the expenditure was therefore to create or materially expand a source or foundation for future income in the long term. In this court's judgment, that points strongly towards its character being capital in nature. Our view of the enduring benefit to the taxpayer contemplated by the tripartite agreement finds support in the declared view of XYZ in its application to ABC concerning the "long term / exit strategy" that "(t)he long term relationship with XYZ gives [T] and the Farmer Trust a sustainable marketing perspective".

[29] The absence of a formal agreement to secure a right by the taxpayer to market the grapes produced by Newco does not appear to us to be significant having regard to the group relationship of the companies and the dominance of the group's appointees on Newco's board of directors. In assessing the context in which the grant contributions were paid by the taxpayer to Newco, it is important to bear in mind the companies' common status as subsidiaries within the T group of companies. Newco's board of directors was, in the majority, comprised of representatives of the holding group, with 3 representatives; the trust having 2 representatives. In this respect, the composition of the board directly reflected the respective extents of the holdings of the taxpayer's shareholders.

[30] One must, of course, accept that Newco's board members would be obliged to act in the best interests of the company, which conceivably might differ from the interests of the T group in various circumstances. Such a situation might occur, for example, if the taxpayer was uncompetitive in its pricing or if it delivered bad service to Newco, neither of which must have appeared likely possibilities to the boards of either the taxpayer or Newco, or indeed that of XYZ, at the time. The evidence supported competitiveness, efficiency and high standards as characteristic features of the taxpayer in particular and the other companies in the group in general, so the postulated situation of Newco exporting its grapes other than through the agency of the taxpayer is not one that anyone involved is likely to have contemplated when the expenditure was committed to. It is in any event difficult to see how the board could be regarded as in breach of its fiduciary duties to the company were it to be guided by the wishes of the majority of its shareholders.

[31] The expectation of a long term working relationship between the taxpayer and Newco is supported not only by their interconnectedness in the group structure, but also by the fact that, as appears from Newco's annual financial statements, various members of the group, including its direct holding company are guarantors in favour of the Industrial Development Corporation up to R*** million in respect of a number of loans advanced by the IDC to Newco. The evidence was that the IDC loans had financed the establishment of the first 100 hectares of vineyards on Newco's land, and that had it not been for the funding provided in terms of the tripartite agreement any expansion of the vineyards would have been unlikely until the loans were redeemed.

[32] Unsurprisingly therefore, hindsight reveals that all of Newco's production has subsequently been placed with the taxpayer for export as agent. From these factors it must be inferred that there was much more than a mere hope on the part of the taxpayer that it would become the exporter of Newco's fruit. It must have appeared practically certain to the taxpayer's board of directors at the time they committed the taxpayer to the contribution expenditure, that the company would be the exporter of Newco's fruit, and the exporter of as much of it as the company chose, for at least as long as the taxpayer and Newco remained sister companies within the T group.

[33] We consider that the taxpayer's tax advisers' invocation of *VRD Investments* supra, in support of their opinion that the expenditure would be of a revenue character was misplaced. The facts in that case were materially distinguishable from those in the current matter. In *VRD Investments*, the taxpayer's expenditure on the purchase of a failing competitor's business was primarily directed at cutting the losses that were being suffered by the taxpayer as a consequence of the discounts and special offers it was having to extend to its own customers for as long as the competitor remained in business. The expenditure expedited the taxpayer's ability to discard the loss-causing aspect of its operations, something that but for the outlay it would otherwise have had to wait several months to do until the inevitable collapse of the competitor's failing business. Unlike the position in the current matter, the expenditure incurred in *VRD Investments* was to improve the income earning efficiency of the taxpayer's business rather than to establish a source of additional income for the business. A further distinguishing feature was that the advantage that the expenditure in *VRD Investments* was directed at securing was of a short-lived character.

[34] On a point of principle, *VRD Investments* was a case bearing comparison with that in *Palabora Mining* supra, on which the taxpayer's counsel placed some reliance in his submissions in support of the appeal. In that matter the taxpayer's expenditure in respect of the construction of public utility waterworks on a neighbouring property that the owner, a water board established in terms of section 108 of the Water Act, 54 of 1965, was committed to building in any event, albeit a year or so later, was characterised as revenue in character, notwithstanding that the waterworks would be used, in part, for the mining operation the taxpayer had established on its land. The use of the statutory water scheme's utility for the purpose of its production had been intended by the taxpayer from the planning stage of its mining operations. It undertook the construction work because of concerns about the impact of the delay by the water board in building the waterworks on the taxpayer's ability optimally to generate income from the mining infrastructure in which it had invested.

[35] The Appellate Division's characterisation of the expenditure as revenue was because its primary object was not to create a source of income the taxpayer otherwise would not have had, but rather to more efficiently work the mining concern that the taxpayer had established on its own property. The expenditure in *Palabora Mining* was calculated to provide the taxpayer with a short-term profitable advantage. It enabled the taxpayer to reap the profit from its established source of income sooner that it would otherwise have been able to. The loss incurred by the taxpayer in respect of expenditure on the construction of the waterworks was more than offset by the profits generated in the resultant accelerated mining production.

[36] The court in *Palabora* considered that a materially distinguishing feature between that case and matters such as *Ounsworth* supra was that "not only did the expenditure in issue neither create nor preserve any right or asset in the hands of the [taxpayer], but also that – as is made clear both in the judgment of the Special Court and in the stated case – the waterworks were, irrespective of [the taxpayer's] intervention, going to be constructed in any event. The expenditure in issue was, therefore, not incurred by [the taxpayer] in order to obtain a long-term supply of water but, as explained earlier in this judgment, solely with the object of accelerating the acquisition of an adequate supply of water in order the sooner to commence earning the estimated profits of three million rand per month." The judgment proceeded "…bearing in mind that the estimated life of [the taxpayer's] mine as an open pit operation is 26 years, I agree with counsel for appellant's submission that the advantage which the [taxpayer] derived from the accelerated construction of the barrage was, and was at all stages intended to be, short-lived and adapted to short term purposes; and that, once the eight month period in 1966 had elapsed, the purpose of the expenditure was (to employ an expression used in *Commissioner of Taxes v Nchanga Consolidated Copper Mines Ltd.,* 1964 A.C. 947 (P.C.) at p. 961) "exhausted", and had no residual value to the [taxpayer]".[15]

[15] At pp.832fin – 833C (SALR). (In *Nchanga*, the benefit or advantage derived from the expenditure there in issue was considered by the Board of the Privy Council to have been "conditioned to last for not more than twelve months". Lord Radcliffe spoke of what the taxpayer had obtained by virtue of the expenditure in the following terms: "… it seems a contradiction to speak of what Nchanga thus acquired, which exhausted itself and was created to exhaust itself within the twelve months period within which profits are ascertained, as constituting an enduring benefit or as an accretion to the capital or income-earning structure of the business. If the expenditure is to be treated as capital expenditure at all, it cannot be for any reason such as that.")

[37] In our view, the facts of the current matter make the case comparable with Income Tax Case 1110 (29 SATC 169), which was referred to and distinguished by the appeal court in *Palabora*.[16] In ITC 1110, as summarised by Ogilvie Thompson JA in *Palabora*, but for the taxpayer's undertaking to indemnify the Administration against any operational loss on a specially constructed railway line over a 10-year period, the line would probably not have been built at all; and, further, the taxpayer (a gold-mining company) could continue to enjoy the facility of the railway line for the duration of its mining operations estimated at some 47 years. At pp. 172-173 (SATC), Hill J said of the taxpayer's claim, in terms of section 11(*a*) of the Income Tax Act, to deduct the amount of the payment made pursuant to the indemnity "… the payment for the benefit has no relationship to the income or expenditure for any particular year but … it relates to the appellant's mining operations as a whole. By giving the undertaking to be responsible for the Administration's losses for ten years the appellant acquired a new and convenient form of conveyance for its goods for the whole life of its mining operations … . This constitutes an improvement of the appellant's income earning structure and therefore an additional asset, the cost whereof is not deductible." Here, as discussed, but for the taxpayer's contribution the expansion of the vineyard would not have taken place in the foreseeable future, but once expanded consequent upon the taxpayer's expenditure all indications are that it will, as intended, provide the latter with a long-term assured source of additional income. In a relevant sense, the expenditure effectively added to the income-producing structure of the taxpayer's business.

[38] In the current case, we accept the evidence of Ms X that the taxpayer being able to market increased volumes of fruit will increase its commission income without significantly adding to its operational costs. It is evident that in the ordinary course any increase in the volume of fruit marketed by the company would flow from increased output by its existing principals through their own endeavours, or expansion of the pool of the producers for whom it markets fruit, alternatively increased purchases by it from local producers for export. What happened in terms of the tripartite agreement was of a quite different character. It entailed a very material outlay by the taxpayer to a fellow subsidiary for the latter to create a vineyard for the production of grapes for the taxpayer to market. The expenditure was incurred by the taxpayer to create or acquire a source of additional income, not to work an existing source of income.

[39] In the result, we are not persuaded that the Commissioner erred in disallowing the expenditure as a deduction in terms of section 11(*a*) of the Income Tax Act, and the appeal against his decision in that regard will be dismissed. It is consequently necessary for the court to consider the second and third bases of the taxpayer's appeal.

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[16] At p.832C-E (SALR).

Remission in whole or in part of the penalty imposed on the taxpayer in paragraph 20 of the Fourth Schedule to the Income Tax Act

[40] The statutory provisions pertinent to this ground of appeal are set out in note 2 above.

[41] The taxpayer's characterisation of its grant to Newco as revenue in nature for the purposes of its returns of income was in accordance with advice obtained from an independent firm of tax advisers. There is no reason to question that its estimation of its taxable income for the purpose of making its payments of provisional tax was "seriously calculated with due regard to the factors having a bearing thereon". The rationale for the professional advice accepted by the taxpayer was not so obviously untenable that the taxpayer should reasonably have recognised it to be incorrect. We believe therefore that had the opinion been disclosed to the Commissioner, he could not but have been satisfied that the taxpayer's estimate was seriously calculated and that it was not deliberately or negligently understated.

[42] In our judgment, the discretion vested in the Commissioner in terms of paragraph 20(2) of the Fourth Schedule to the Income Tax Act falls to be exercised in favour of the taxpayer in the given circumstances, and we shall accordingly direct that the penalty imposed in terms of paragraph 20(1) be remitted in whole.

The taxpayer's liability to pay interest in terms of section 89*quat* of the Income Tax Act

[43] The statutory provisions pertinent to this ground of appeal are set out in note 3 above.

[44] The phrase "is a result of circumstances beyond the control of the taxpayer" in section 89*quat*(3) of the Income Tax Act denotes the incidence of a causative factor or factors for the underpayment unrelated to any act of volition by the taxpayer. In our judgment, the underpayment of provisional tax by the taxpayer was a consequence of it following professional advice that we have found to have been erroneous. The decision to do so was something wholly within its control. The underpayment in issue did not occur in the sort of circumstances posited by section 89*quat*(3), and there was therefore no basis for the Commissioner to waive the interest.

[45] The taxpayer's third ground of appeal fails accordingly.

Costs

[46] The parties were ultimately agreed that a costs order was not warranted (cf. section 130 of the Tax Administration Act 28 of 2011).

Order

1. Subject to paragraph 2 of this order, the notice of assessment dated 2020-06-26 issued by the Commissioner concerning the additional assessment in respect of the taxpayer's 2016 year of assessment is confirmed.
2. The aforementioned notice of assessment must be altered to reflect the remission in whole of the under estimation penalty imposed in terms of Paragraph 20 of the Fourth Schedule to the Income Tax Act 58 of 1962.
3. The taxpayer's appeal in terms of section 89*quat*(5) of the Income Tax Act is refused.

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A.G. BINNS-WARD
President of the Court

CONCUR:

D. WARNEKE (Accounting member)
M. TITUS (Commercial member)

DATE OF HEARING: 29 and 31 May 2023
DATE OF JUDGMENT: 19 July 2023