

IN THE INCOME TAX SPECIAL COURT

BEFORE

The Honourable Mr Justice LI Goldblatt

President

AC Geake

Account Member

MC van Blerck

Commercial Member

In the appeal of WAC (PTY) LIMITED

CASE NO 1990

(Heard at Johannesburg on 21 November 2003)

JUDGMENT

JOHANNESBURG

11 February 2004

GOLDBLATT J

1. At the commencement of this matter we were informed that the parties had prepared a statement of agreed fact and that this court would be asked to decide at this stage only whether the disposal by the taxpayer of a portion of its interest in a partnership could give rise to a recovery or recoupment in terms of section 8 (4) (a) of the Income Tax Act no 58 of

1962 (“the Act”) of allowances granted to the taxpayer in terms of section 14 *bis* of the Act.

2. The following facts were agreed upon between the appellant and the Commissioner:

“2.1 On or about 31 March 1989 the Appellant (then known under another name) entered into the written partnership agreement which is at p 35 of the Dossier (“the SCA Partnership agreement”). In terms of the SCA Partnership agreement the parties thereto agreed to carry on business together in partnership, under the name “The SCA Partnership.”

2.2 On or about 31 March 1989 the SCA Partnership and BA (Pty) Ltd concluded the written partnership agreement which is at p 73 of the Dossier (“the SB Partnership agreement”). In terms of the SB Partnership agreement the parties thereto agreed to carry on business together in partnership under the name “The SB Partnership”.

2.3 In order to finance its contribution to the SCA Partnership in terms of the agreement referred to in paragraph 2.1 above, the appellant concluded a loan agreement with A Bank Ltd, a copy of which is at p 187 of the Dossier (“the loan agreement”).

2.4 Pursuant to the loan agreement A Bank advanced the sum of R5 593 235 to the appellant and the appellant advanced the said sum to the SCA Partnership in fulfillment of its obligation in terms of clause 3.2 of the SCA Partnership agreement.

2.5 Pursuant to the conclusion of the SCA Partnership agreement and the contribution of R5 593 235, referred to in paragraph 2.4 above, the appellant’s share of the profits, losses, rights and obligation of the SCA Partnership (hereafter referred to as the appellant’s percentage interest in the partnership) was 30% thereof.

2.6 The SCA Partnership purchased an aircraft for a purchase price of R19 933 047 for the purpose of carrying on its business ("the aircraft") and commenced business utilising the aircraft. As a result the partners in the SCA Partnership became entitled to their *pro rata* portions (calculated in terms of section 24H of the Income Tax Act, 58 of 1962 ("the Act")) of the allowances in terms of section 14*bis* of the Act in respect of the aircraft.

2.7 In the years of assessment ended 31 March 1989, 1990 and 1991 the appellant claimed its *pro rata* portion (calculated in terms of section 24H of the Act) of the allowances in terms of section 14*bis* of the Act in respect of the aircraft. The allowances claimed by the appellant were as follows:

2.7.1	1989	R2 391 657,00
2.7.2	1990	R1 512 562,00
2.7.3	1991	R1 512 612,00

2.8 In March 1991, in accordance with a letter dated 21 March 1991, A Group Data (Pty) Ltd, BA (Pty) Ltd and ASC Management Company (Pty) Ltd concluded an agreement in terms of which A Group Data Ltd sold to BA (Pty) Ltd the shares in ASC Cross Management Company (Pty) Ltd of which A Group Data Ltd was the owner. The said letter and the said agreement are at pp 205 and 208 of the Dossier. In terms of the said agreement A Group Data Ltd warranted that on the effective date of that agreement ASC Management Company (Pty) Ltd would have been effective 99,9% interest in the SCA Partnership.

2.9 In 1981 a written supplementary agreement was concluded by A Bank Ltd, A Group Data (Pty) Ltd, BA (Pty) Ltd and ASC Management (Pty) Ltd. A copy of this agreement is at p 118 of the Dossier. In terms of clause 5.2.1 of the said agreement A Group Data (Pty) Ltd undertook to procure that as at the effective date of that agreement the partnership

interest of ASC Management (Pty) Ltd in the SCA Partnership would have been increased to 99,9%.

- 2.10 In order to ensure compliance with the warranty referred to in paragraph 2.9 above, each of the partners in the SCA Partnership, other than ASC Management (Pty) Ltd, disposed of 99,9% of its percentage interest in the SCA Partnership to ASC Management (Pty) with effect from 2 July 1991. As a result thereof the appellant's percentage interest in the said partnership was reduced from 30% to 0,03%.
- 2.11 In consideration for the appellant disposing of 99,9% of its percentage interest in the SCA Partnership to ASC Management (Pty) Ltd, A Bank Ltd released the appellant from the outstanding balance of the appellant's liability to A Bank Ltd in terms of the loan agreement, being an amount of R6 047 670,18.
- 2.12 The aircraft continued to be owned by the SCA Partnership throughout the 1992 year of assessment and was only disposed of by such partnership in 1995.
- 2.13 The Commissioner has assessed the appellant for tax in the 1992 year of assessment on the basis that the Commissioner contends that the disposal by the appellant of 99,9% of its percentage interest in the SCA Partnership to ASC Management (Pty) Ltd during that year, for the consideration of R6 047 670,18, resulted in a recoupment in terms of section 8(4)(a) of the Act of the allowances referred to in paragraph 2.7.
- 2.14 The appellant disputes that the disposal by the appellant of 99,9% of its percentage interest in the SCA Partnership to ASC Management (Pty) Ltd during that year, for the consideration of R6 047 670,18 resulted in a recoupment in terms of section 8(4)(a) of the Act of the allowances referred to in paragraph 2.7 above."

3. The partnership agreement to which appellant was a party created a partnership *en commandite*. Thus the names of the partners were not disclosed to outsiders and the partners, save for the managing partner, were only liable for the amount of each such partner's agreed capital contribution.
4. In terms of the SB partnership agreement (p 73 of the Dossier), the SCA partnership contributed the aircraft which it owned to the partnership which then operated the aircraft and a formula was created to provide what profit or returns the SC partnership would be entitled to before BA could share in the profits. In effect BA was guaranteeing SC a specific return on the value of the aircraft.
5. Section 14*bis* of the Act, during all relevant times, provided for the deduction from the income of a person in respect of an aircraft acquired by such person and used by him for the purpose of his trade during the year of assessment of various allowances, equal to various percentages, starting off with an initial allowance of 40% on the "adjustable cost or adjustable estimated cost" of the aircraft in the first year followed by an annual allowance of 25% for the next two years and a final 10% allowance in the fourth year after the acquisition of the aircraft. This had the effect of reducing the "tax value" of the aircraft to nil four years after the aircraft was brought into use.
6. The basic argument of the appellant is to be found in paragraphs 23, 24 and 25 of the appellant's heads of argument which paragraphs read as follows:
 23. When the appellant and the other partners disposed of or transferred 99,9% of their percentage interests in the partnership to ASC Management (Pty) Ltd pursuant to the agreement referred to in paragraph

10 of the Agreed Statement of Facts, this simply resulted in an adjustment of their respective percentage interests in the partnership. It did not result in a disposal of the aircraft or in a dissolution of the partnership. No new partners were admitted and none of the existing partners left the partnership. (See Joubert's The Law of South Africa Volume 19 First Re-issue, paragraph 319 at p 274). Therefore, there was no disposal of the aircraft which could give rise to a recoupment.

24. Moreover, the consideration to which the appellant became entitled was not consideration for the disposal of the aircraft. It was not a refund of an amount paid for the aircraft. It was not a release from an obligation to pay for the aircraft. It was simply consideration for the transfer by the appellant of 99,9% of its percentage interest in the partnership.
25. It is submitted that in these circumstances the amount received cannot be regarded as a recovery or recoupment of the allowance previously claimed in terms of s 14*bis*, which was based upon the cost of acquisition of the aircraft by the partnership. The cost of acquisition of the aircraft was not in any way recovered or recouped by these events. There was no connection between the amounts previously claimed as deduction by the appellant in terms of s 14*bis*, based upon the cost incurred by the partnership in acquiring the aircraft, and the consideration to which the appellant became entitled pursuant to the disposal or transfer of a part of its percentage interest in the partnership to one of the other partners.
7. These submissions in our view are fatally flawed in that, as will appear more fully hereunder, they failed to recognise the true nature and effect of a partnership agreement.
8. "A partnership" is a legal relationship arising from an agreement between two or more persons each to contribute to an enterprise with the object of making profits and to divide such profits (The Law of Partnership and Voluntary Association in South Africa by B Bamford [3rd Edition] page 1).

Thus each time the relationship between the partners is altered a new partnership is constituted and the old partnership dissolved.

9. Since a partnership is not a legal persona it cannot own the assets utilised in the business enterprise as a separate entity itself and thus the partnership assets are held by the partners as co-owners in undivided shares. A partner's share in a partnership is described as follows in The Law of South Africa, first re-issue, volume 19, paragraph 296, p 242:

"A partner's share in a firm has a dual nature. In the first place, a partner's share comprises his proportionate interest in the partnership property after it has been realised and converted into money and all partnership creditors have been paid. In this context a partner's share denotes a partner's right to claim a specific portion of the partnership assets (such as profits) when this portion is due. In the second place a partner's share in a firm merely denotes his *pro rata* interest in the particular items of a partnership assets, apart from any realisation of the property as such. In this context a partner's share comprises his interest in jointly owned partnership property (that is his undivided share in these assets), together with his interest in all other partnerships property, including profits.

10. Because the appellant owned an undivided share in the aircraft it was entitled to the allowances in terms of section 14*bis* of the Act which the Commissioner alleges it has since recovered or recouped.
11. When the appellant agreed to transfer 99% of its share in the partnership to ASC Management (Pty) Ltd it was, *inter alia*, undertaking to transfer 99% of its undivided share in the aircraft and other assets of the partnership (which may have existed) to ASC Management (Pty) Ltd. It was also agreeing to transfer 99% of its right to participate in the profits of the partnership.

12. The appellant received compensation in an amount of R6 047 670,18 from A Bank Ltd for transferring the aforesaid assets and accordingly to the extent that all or part of this amount was compensation for the transfer of 99% of appellant's undivided share in the aircraft, it constituted a recovery or recoupment of the deductions previously claimed by the appellant in terms of section 14*bis* of the Act. The allowances claimed and allowed were merely in relation to the depreciation of the value of the aircraft and did not relate to actual expenditure by the partnership and thus to the extent that the compensation received by the appellant exceeded the written off value of the appellant's undivided share in the aircraft, the appellant has recovered or recouped the allowances to which it was entitled in terms of section 14*bis* of the Act.

13. In our view the disposal of the share in the partnership is a poorly disguised manner of disposing, *inter alia*, of ownership of a share in the aircraft and thus there is a direct connection between the amount received for the share in the partnership and the amounts previously deducted. To the extent that the amount received by the appellant for its share in the aircraft exceeds the written down value of the aircraft there will have been a recovery or recoupment of the allowances granted to it.

CONCLUSION

We accordingly hold that to the extent that the credit of R6 047 670,18 received by the appellant from A Bank Ltd was compensation for the appellant transferring 99% of its interest in the aircraft owned by the SCA partnership, such amount is a recoupment by the appellant or allowances granted to it in terms of section 14*bis* of the Income Tax Act no 58 of 1962.

On behalf of Mr AC Geake (Accounting Member)
Mr MC van Blerck (Commercial Member) and myself

LI GOLDBLATT – PRESIDENT

This judgment should be reported **YES**

Adv PA Solomon SC, instructed by Werksmans Attorneys, appeared on behalf of the appellant.

Adv G Stevens represented the Commissioner on the South African Revenue Services.