IN THE TAX COURT
HELD IN JOHANNESBURG

ITC CASE NO: 11220

Before:

President: The Honourable Ms Justice K Satchwell

Accountant Member: Mr W B Cronje
Commercial Member: Mr V A Jiyane

JUDGMENT

SATCHWELL J:

INTRODUCTION

1. This appeal by the taxpayer raised questions concerning the purpose, nature, and import of Restraint of Trade agreements.

2. This taxpayer entered into three agreements with his employer which he identifies as 'Restraint of Trade' agreements. For concluding the first such agreement in 1992 he was paid the sum of R350 000, for concluding the second such agreement in 1996 he was paid the sum of R1, 25 million and for concluding the third such agreement in 1998 he was paid the sum of R 3 million.

3. Revised additional assessments were raised by the Commissioner (for the 1996 and 1998 years) against the taxpayer on the basis that the aforesaid sums paid were of an income nature and taxable. The Commissioner's case is that these restraint payments were not genuine in nature. The appellant taxpayer, contends that these restraint payments were genuine, of a capital nature and not taxable.

4. At the hearing, the taxpayer gave evidence. By agreement between the parties, a bundle of documents was handed up on the basis that they are what they purport to be. The Commissioner led no witnesses and attempted to introduce into evidence certain information pertaining to the demise of and the liquidation of the D group [1].

BACKGROUND TO EMPLOYMENT OF TAXPAYER

5. The taxpayer, with commerce and law degrees, was employed by B (Pty) Ltd, initially as a sales representative and ultimately as the National Sales Manager. Throughout his employment with B, he was engaged in the field of medical products.

6. He was exposed to a wide range of processes and products over a period of approximately ten years. In C, where there was a factory, he learned about adhesives, swabs and dressings; in the Transvaal he managed the portfolio of medical products and learned about sourcing, pricing and tendering; in the United States of America he underwent courses and gained expertise in drapes, gowns and disinfectants, haemostasis products and wound dressings. He accessed new technology for developing different types of bandages; he developed the " pack and tray" business; he launched gowns and set up manufacturing for products such as bandages, swabs and jellies. In the United States he gained further knowledge on filter medias, face masks, disinfectants, solutions and learned more about drapes and gowns; he visited manufacturers and observed the processes. He established contacts within B and throughout the world as regards sources, supplies, pricing and tendering. His knowledge included the training of sales persons; creation, development and implementation of strategies; adjustments to products and development of new products. He was well acquainted with the customer

[1] It was common cause that Section 82 of the Act raises a statutory presumption in favour of the validity of an assessment issued by the Commissioner and that the onus is placed on the taxpayer to show that an amount included in the assessment is not taxable. The onus is required to be discharged upon a balance of probabilities.

base for medical products and had a wide range of contacts in all fields applicable to this area of commercial enterprise.

7. Whilst employed at B, the taxpayer identified D (Pty) Ltd as a potential acquisition. He targeted both D and E of which D held the lucrative agency. He ensured that B competed with their products, undercut them on price and challenged them on tenders. His opinion was that he ensured that B acquired business at the expense of D and accordingly "inflicted severe damage" on D. Notwithstanding approaches to acquire D, the result was an approach by D for the taxpayer to join that company. This he eventually did in 1992 as Marketing and Sales Director for the E division of D.

EMPLOYMENT OF TAXPAYER AT D

8. A package was negotiated between the taxpayer and D which provided for a basic monthly salary, a reimbursive entertainment allowance, participation in a "sales incentive program" in terms whereof quarterly bonuses were paid, a Christmas bonus approximate to a 13th cheque, further discretionary special bonuses and a car allowance. On joining D, the taxpayer was allocated a significant shareholding in the D Share Trust on certain terms and conditions. Additional shares were to be made available to him at the discretion of the Board of Directors. Over the approximately seven years of his employment with the D group the basic salary, allowances and bonuses increased considerably.

9. The taxpayer exercised his share options as and when he was entitled. His evidence was that he considered his remuneration package to be "good" but because " I opted for more and more stock options" he considered himself to be in receipt of an "exceptional package". "As a general package, and with the stock options available, my remuneration was better than in the industry". As the years passed, the taxpayer took up all share options available to him and kept the shares. According to the taxpayer, the increase in the D share price meant that "my wealth increased

dramatically". He estimated that by 1996 his D shareholding was valued at approximately R5 million and by 1998 at approximately R12 million and, prior to the liquidation of D, in the region of R 25 million.

TAXPAYER CONTRIBUTION TO D EXPANSION

10. The taxpayer gave evidence of a most impressive period of experience gained, information acquired, contacts met and innovations introduced during his period with the D group.

11. The taxpayer attended a vascular congress in Chicago where he met surgeons who were responsive to D products; in Arizona he was introduced to the manufacturing processes of certain products; in Boston he was exposed to the range of products marketed by E and was exposed to the gauze business. He came to understand how business was undertaken in the United States of America which made the relationship between E USA and D easier. He introduced systems as well as a new marketing and sales approach within D; he poached key sales persons from B to join D and replaced the entire sales force; he procured the transfer of a Hong Kong supplier of gauze and swabs at excellent pricing from B to D. He put together a strategic 5 year plan for D. In Germany he attended an Exhibition at which he made certain introductions and acquired certain agency business; he met colleagues with contacts in other countries, such as India, where D was thereafter able to source supplies at competitive prices; he observed manufacturing businesses of E. He developed valuable contacts within Europe as regards both processes and products which enabled him to determine whether these could be reproduced in South Africa. When D was in dire straits in 1992 he initiated and implemented a plan for saving the company which involved using his gauze sourcing out of China to undercut B and F in South Africa, cleaning out inventory at different D warehouses; and increasing the sales line several million Rand above forecast. In France he attempted to obtain an agency for syringes, needles and IV catheters, and in so doing received training, with the result that the award was made to D because he

had the necessary technical expertise in these products. On the basis of products with which he had worked at B, he developed a product for D. Recipes for the manufacture of hospital packs were developed in the make up of which sourcing of components was critical. An important F tender was secured. He identified H as a potential acquisition. Through extensive travels through the USA and Germany he acquired new products for D. While visiting the USA he approached I and acquired the agency for surgical sutures for South Africa, underwent an extensive training program himself, recruited sales people exclusively for I in South Africa, and after a tough battle acquired R20 million in business which had formerly been done by B.

12. After discussions with J in France, it was decided to find a local manufacturer for certain products and accordingly K (Pty) Ltd (K) was acquired. With the expansion of the consumables side of D business, the appellant moved technical products, such as IV catheters, gloves, syringes etc. into K. The Vacutainer acquisition was housed in K; glove manufacturing was set up in K; product management was set up in K. Specific tenders were bid for out of K.

13. The relationship which the appellant had developed with E in Boston was such that he was able to “pick the plums” from the E product list and market them in South Africa and eventually he proposed the idea of a joint venture company which was formed in 1995/1996 in which D had a 49% shareholding. The appellant was appointed managing director of E SA. He visited approximately eleven E manufacturing facilities in the USA and Mexico and was familiar with the entire range of E products.

14. The dramatic expansion of the D Group is set out in two documents attached to the 1998 Annual Report. This correlates with the evidence of the witness. D was formed in 1985 following a management buy-out of the South African operations of E, then the medical division of L. D was listed on the Johannesburg Stock Exchange in 1987. From turnover of R1.2 million in 1986 it reached R456 million in 1998.

RESTRAINTS OF TRADE

15. The taxpayer entered into three agreements which he submits are all Restraints of Trade: the first on joining D and the two subsequent documents in the course of his continuing employment. The three documents are identical in structure and virtually identical in content. The taxpayer testified that these had been prepared by the accountants and were "standard agreements" used by the Company.

Parties

16. The 1992 agreement was entered into between D Health Care Limited and the taxpayer whilst the 1996 and 1998 agreements were entered into between International Latex Products (Pty) Ltd and the taxpayer. The latter two agreements were signed by the taxpayer both in his capacity as a Director of K ('the Company') and in his capacity as 'the employee'.

Structure and Content

17. Each agreements commences with the same preamble:

> "WHEREAS:
>
> A. The employee is employed in a senior position by the Company and is one of the key personnel of the D Group.
>
> B. By virtue of his association with the D Group, the employee is possessed of and has complete access to the D Group's accumulation of trade secrets and confidential information.
>
> C. In addition to his knowledge of the trade secrets and confidential information of the D Group already acquired, the employee will continue to acquire further such knowledge through the continuation of his employment by the Company.
>
> D. If, on termination for any reason whatever of the Employee's employment within the D Group, the Employee takes up employment or otherwise becomes associated with or interested in any competitor of the D Group, the proprietary interest of the D Group in its trade secrets and confidential information will suffer.
>
> E. The Employee recognises and acknowledges the contents of the foregoing and that the provisions hereof

> are fair and reasonable and necessary for the protection of the proprietary interest of the D Group in its trade secrets and confidential information."

18. The concept of "trade secrets and/or confidential information" is defined in great detail in each document which is not necessary to repeat. In each document, the employee agrees that he shall be restrained in exactly the same respects. He shall keep confidential trade secrets and confidential information (clause 3.1), shall not procure D employees to engage in any business competitive with the D Group (clause 3.2.1), shall not furnish any information acquired as a result of his employment to any other person (clause 3.2.2) and shall not be directly or indirectly interested or engaged in any competitive undertaking (clause 3.3).

19. Each document records that the restraints applied against the taxpayer "while he is employed in any capacity within the D Group and for [a specified] period from the date of termination of such employment". . The agreement dated 4th May 1992 provides for a period of two years while the document dated 2nd April 1996 provides for a period of six months and the document dated 2nd April 1998 provides for a period of two years.

Consideration

20. There was a financial consideration payable to the taxpayer on signing of each of these agreements, which payments form the subject of this hearing.

21. Clause 4.1 provides that "in consideration for the protection afforded the D Group as a result of the employee undertaking the restraint set out at clause 3 above, the Company shall pay the employee" one of the amounts already identified.

22. It was agreed that the consideration constituted "reasonable compensation".

Enforceability

23. The rights of D to enforce each of these agreements was identified as all those which the company may have in terms of the common law (clause 4.3).

24. Further, in terms of each clause 4.3, "in the event of a breach by the employee of any of the terms of this Agreement, the employee shall, within 7 (seven) days of receipt of written notice from the Company, repay to the Company the entire amount of the consideration paid to him in terms of clause 4.1 above."

Payments

25. The consideration pursuant to the 1992 agreement was the sum of R 350 000 to be effected in 6 annual instalments which was paid in 5 annual instalments; the consideration pursuant to the 1996 was R 1,25 million to be effected in 5 annual instalments which was paid in 4 such instalments; the consideration of R 3 million pursuant to the 1998 agreement to be effected in 5 annual instalments was paid in two instalments in the same year.

Buy-out option

26. The taxpayer was also given the option of choosing to refund the sums he had been paid "in which event he shall be released from the provisions of Clause 3". (clause 4.4).

27. This opportunity to elect to be released from all restraints, through repayment of the consideration paid by the company or group, was subject to two conditions. The first was that his employment had ceased. The second was that the Managing Director of the company at the time the taxpayer ceased be an employee had not been a director of the company at time of signature of the agreement. The evidence of the taxpayer was that he had, despite enquiry, never understood the meaning or import of this last requirement.

Circumstances of Signing the Agreements

28. The taxpayer testified that he had negotiated none of the terms of these agreements save that he had indicated the sums of money which he expected as a consideration.

29. He signed the 1992 agreement on commencing employment with D. At the time, he was given to understand that this was a standard term and condition of employment. He accepted that if he breached these restraints he would "have been able to assist a competitor to inflict severe damage on D". He understood that the result of the Restraint of Trade agreement was that "for a period of two years I would not be able to attack the Company in any way and they would be able to put together a defensive strategy". If he had left this would have had "a severe effect on D's day to day business" because he would have been in a position to take customers, strategies and tenders with him

30. The taxpayer testified that the 1996 agreement was prepared because Mr Len Flynn of Tyco Corporation, the holding company of E, expressed concern that key personnel should be further restrained from inflicting damage upon D and/or E now that the two companies had entered into the joint venture known as E SA. Mr Flynn was aware that the taxpayer had signed the 1992 restraint but was "uncomfortable that I could buy myself out for R350 000". He preferred a larger restraint payment. Accordingly, the 1996 agreement was concluded. The taxpayer considers that the specified restraint period of six months after termination of employment would have been an adequate period to enable D and/or E "get to suppliers and bed down agencies".

31. The taxpayer testified that the 1998 agreement was prepared for two reasons. Standard Corporate and Merchant Bank had, both directly and indirectly, invested in D acquisitions. A Mr Hempel of Standard Bank, according to the taxpayer, requested that it was to be ensured that the directors were "adequately restrained". The company was to be protected "against anyone leaving and causing damage". In addition, Tyco Corporation/E had approached the taxpayer to work for E. Aware of both the 1992 and 1996 agreements, Tyco/E had offered to buy the taxpayer out of his restraints by paying to the D Group the sums of money involved. The result, says the taxpayer, was that he was offered a further

restraint of trade which he says was "in line" with what new senior employees were receiving. He testified that the true purpose of this agreement was "to prevent me leaving and inflicting damage by poaching people and taking market share from the Company".

THE ISSUE

32. The issue before this court is whether or not the amounts in issue - of R350 000 , R1,25 million and R 3 million - were of a capital nature. This issue has been formulated differently by both parties.

33. In his objection of 21 February 2000, the taxpayer set out the relevant terms of the three agreements, the background therefor and concluded that these constituted capital payments which are not taxable. The taxpayer proceeded on this basis at the hearing before this court.

34. The court has not been provided with a copy of any letter which may have accompanied the assessments by the Commissioner and which might have disclosed the basis of the assessments. The Commissioners response to the objection dated 2nd August 2000 was to advise "I am unable to agree with your contentions" and to disallow the objection. In his undated Statement of Case, the Commissioner states that the "Respondent's case is that these restraint payments were not genuine in nature". At the hearing the Commissioner argued that the submission that these 'Restraints of Trade' were not genuine had to be placed in "its historical context. Accordingly, one needs to take cognisance of the circumstances surrounding the liquidation of D".

35. To this end, the Commissioner attempted to hand in as evidence a series of newspaper articles concerning the liquidation of D and associated matters pertaining to other directors, payments made to other directors, restraints involving other directors, the financial difficulties in which the D group found itself, the work of and the views of the Liquidators and so on. These were held not to be admissible. Similarly, the Commissioner

presented the taxpayer with copies of a Particulars of Claim in litigation initiated against him which had been settled as well as portion of the transcript of the evidence in a section 417 enquiry in terms of the Companyies Act. These were admitted solely to enable the taxpayer to comment thereon, insofar as he was able to do.

36. In essence the Commisioner attempted to present a case that the payments made to the taxpayer were made, in part, in the knowledge of the precarious financial position of D and with foreknowledge of the impending liquidation of the group.

37. This court must make it clear that this hearing is not concerned to investigate and make any finding as to the causes of the demise of the D group. We have no evidence before us of any agreements between other directors of the group and payments made to them. The court is not in any way competent to pronounce on any conspiracy theory which essentially amounts to the argument that this taxpayer was party to a pre-liquidation looting of the coffers of the D group.

38. In determining whether or not the amounts in issue fall within the taxpayer's income and accordingly his taxable income, such amounts would have to fall within the definition of 'gross income' which (at the time) excluded "receipts or accruals of a capital nature". Accordingly, the essential issue is whether the payments in terms of the 1992, 1996 and 1998 agreements were indeed considerations for a 'Restraint of Trade'.

RESTRAINTS OF TRADE

39. Restraints of Trade entered into between employer and employee are devices to protect an employer's proprietary interests from misuse by an employee whether during employment or thereafter[2] .

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[2] This is the general import of many judgments including Magna Alloys and Research (SA) Ltd v Ellis 1984(4) SA 874 (A); Sibex Engineering Services (Pty) Ltd v Van Wyk and Another 1991(2) SA 482 (T).

40. They consist in restrictions on the freedom to trade or to practice a profession [3]. Accordingly they are to be strictly interpreted. They will be carefully scrutinised to identify the existence and nature of the proprietary interest which is deserving of protection as also the existence and nature of the prejudice alleged to be suffered by reason of offending behaviour[4].

41. Such restraints and mechanisms for enforceability are incorporated into agreements and enforced by the common law and by specific terms because assurances are not enough and an employer, with valuable and vulnerable proprietary interests "should not have to content itself with crossing its fingers and hoping that the first respondent would act honourably or abide by the undertakings that he has given" – per Marais J in BHT Water Treatment (Pty) Ltd v Lesley & Another 1993(1) SA 47 at 58 .

RESTRAINT PAYMENTS OF A CAPITAL NATURE

42. An amount received as consideration for a restraint of trade undertaking is of a capital nature[5]. Prior to enactment of the Taxation Laws Amendment Act 30 of 2000, such payments were excluded from 'gross income". The reason for such exclusion is found in the nature and effect of the restraint undertaking itself.

43. The subject matter of the undertakings given by the employee constitutes an asset in his or her hands. That asset is the unfettered ability to earn a living or engage in entrepreneurial activity. It has been described as the right to be "free to engage in useful economic activity and to contribute to the welfare of society by the exercise of the skills in which he has been trained". [6] This right to trade freely is an incorporeal asset. [7]

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[3] See Sunshine Records (Pty) Ltd v Frohling & Others 1990(4) SA 782 (A).
[4] See Magna supra; Sibex supra; Sunshine supra; Basson v Chilwan and Others 1993(3) SA 742 (A).
[5] Taeuber & Corssen(Pty) Ltd v SIR 1975(3) SA 649 (A); Tuck v CIR 1988(3) SA 819 (A).
[6] Per the minority judgment of Eksteen AJA (with which the majority did not disagree) in Basson v Chilwan and Others 1993(3) SA 742 AD .

44. When a person undertakes not to exercise a trade in a specified area for a defined period of time in return for some compensation, he or she is surrendering or 'sterilising', in whole or in part, such asset. [8] By such undertaking, a person "surrenders a portion of his income-earning capacity" or engages in "a "restriction upon that right" [9]. The employee accepts that certain rights are constrained, opportunities are limited, fields of endeavour are circumscribed , the scope for realisation of certain ambitions may be inhibited. These restrictions may be determined by duration of time, geographical area, sphere of activity, capacity of endeavour and so on.

45. Payment received for such a restriction would, if intended to compensate for the loss of part of a person's income-producing capacity or opportunities, therefore be a capital receipt.[10] The "Employee who by means of a covenant in restraint of trade surrenders a portion of his income–earning capacity in return for a payment of money, is parting with a capital asset and the payment is of a capital nature"– per McEwan J, ITC 1338 supra at 174.

46. Accordingly, " The question here is whether for the purposes of 'gross income' the amount paid was or was not a receipt or accrual of a capital nature, in other words, whether it was intended to compensate for the temporary loss of part of appellant's income-producing structure…" per Rumpff CJ in Taeuber supra. At 663E

THE 1992 AGREEEMENT

47. The justifications for the restraints are set out in the preamble and elsewhere in the document several times in different ways , for example in

[7] See Tuck supra; ITC 1338 (1980) 43 SATC 171; ITC 772 19 SATC 301.
[8] Glenboig Union Fireclay Co. Ltd v Commissioner for Inland Revenue, 12 T.C. 427.; Tuck supra; ITC 1338 supra; ITC 772 supra.
[9] ITC 1338 supra.
[10] Tuck supra; ITC 1338 supra; Taeuber supra;

clause 3.5.2. D knew the achievements of the taxpayer whilst at Band had experienced the impact of his adverse targeting. D had good reason to fear the damage he could do, while in employment or on termination of his employment with the group, if he chose to enter into competition with his former employer. After all he had poached sales staff and targeted the products, prices, suppliers, agencies, market and staff of J&J.

48. The proprietary interests of D appear both from the testimony of the taxpayer concerning his activities and achievements whilst in the employ of D and from the documentation attached to the 1998 Annual Report which has already been summarised. The experience of the taxpayer whilst in the employ of Bis also, by analogy, illustrative of the nature of the interests of D and their vulnerability to the predations of an informed, motivated and experienced current or erstwhile employee.

49. The restraints themselves are not in conflict with public policy. They are limited as to duration, field of activity, and areas of competition. They do not overreach the need to protect valid proprietary interests. This is not merely a question of excluding competition but of defending and preserving the lifeblood of the D group.

50. The measures for enforcement are not offensive. The common law permits a multiplicity of steps which may be taken singly or in combination including interdicts restraining the employee from engaging in the prohibited activity subject to directions as to period, manner, geographical area, capacity, sphere of activity and so on; interdicts restraining a third party from dealing with the employee on certain terms and conditions; actions for damages against a current or erstwhile employee or third party for the loss which has been suffered by reason of engagement in the prohibited activities. A further penal provision is the obligation to repay the consideration of R 350 000 if the taxpayer engaged in any one of the prohibited activities during the period of restraint. This exaction of retribution may be viewed as one of the coercive methods

permitted to an employer who has obtained such restraints through payment of a consideration.

51. By reason of the basis of the decision reached in this matter, it is not necessary to fully consider the two pronged nature of the payment of this sum of R 350 000 – on the one hand one of the rewards for not entering into the prohibited activity and on the other hand a deterrent against so doing. This raises the question whether the employer has merely subsidised the payment of the penalty imposed for breaching the restraints. If this was the case, then it is arguable that this was a disguised or simulated penalty and the so-called Restraint of Trade was merely a vehicle to enable such income to be received without being taxed. After all, genuine remedies for enforcement are availed by the common law.

52. We are satisfied that there were indeed trade secrets and confidential information of D to which the taxpayer had unique access; that D would be vulnerable to any competitive misuse by the taxpayer of such interests; that the taxpayer was of an age, with qualifications experience, seniority and ambition which would enable, and perhaps encourage him, to so use these trade secrets and confidential information; that the consideration for the restraints was commensurate both with the potential harm appreciated and the value of him to the group as reflected in his work and in his total remuneration package.

53. In short, the full court finds that the 1992 agreement was a valid Restraint of Trade and that the consideration of R 350 000 paid to the taxpayer was a capital receipt in his hands and is therefore not taxable.

THE 1996 AND 1998 AGREEMENTS

54. Mr Solomon, appearing for the taxpayer, submitted that the existence of the agreements constituted prima facie evidence that these are the terms agreed by D and the taxpayer. The Commissioiner, contending to the

contrary, bears the burden of rebutting such prima facie case[11]. In the absence of factors which would rebut such prima facie case, Mr Solomon submitted that this court should find that the 1992, 1996 and 1998 agreements indeed reflect true agreements.[12]

55. In giving careful consideration to these 1996 and 1998 agreements we take the view that this court should follow the "basic principle that the court must not merely look at the form of the relevant transaction , but also at its real nature"[13] .

56. Where purported Restraint of Trade agreements are challenged than it is indeed appropriate, as pointed out by Ms Mohamed appearing for the Commisioner, to ascertain whether it was and could ever have been intended that these agreements "would inter partes have the effect according to its tenor"[14].

Continuing operation of the 1992 agreement

57. It is common cause that the taxpayer continued in his employment with the D group until the liquidation of the group at the end of 1999. It is also common cause that the taxpayer did not buy himself out of the restraints imposed in the 1992 agreement as provided for in clause 4.4. The 1992 agreement was subject to no expiry date.

58. There is no evidence before us that any provision of the 1992 agreement had been cancelled or amended, impliedly or explicitly. It can only be concluded that the 1992 Restraint of Trade agreement remained operative. Mr Solomon, appearing for the taxpayer, conceded that this was so. Accordingly, the obligations assumed by the taxpayer vis a vis the D group continued to operate against him.

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[11] Vide ITC 1636 60 SATC 267 and CIR vConhage (Pty)Ltd 1999(4) SA 1149 (SCA)
[12] See in this regard Vasco Dry Cleaners v Twycorss 1979(1) SA 603 (A)
[13] ITC 1338 supra.
[14] ITC 1703 63 SATC 247 at 256

59. The 1992 agreement was still extant. The provisions of this agreement were still in effect. The taxpayer had surrendered or sterilised his income producing capacity in a number of defined ways for the duration of his employment with D and for a period of two years thereafter. He was still in employment. He was still subject to those restraints for which he had received the sum of R 350 000 as a consideration[15].

What Capital Exchange or Quid Pro Quo?

60. Those restrictions or obligations were set out in clause 3 of the 1992 agreement as follows:

> "In order to protect the D Group from damage resulting from the utilisation to its detriment of the knowledge and experience acquired by the employee in one or more or all of the respects mentioned in clause 2 above, it is hereby agreed between the parties that –
>
> 3.1 the Employee shall keep as confidential and shall not disclose to any person, firm or corporation any trade secrets and/or confidential information relating to the businesses and affairs of the D Group other than to person connected with the D Group who are required to know such trade secrets or who are privy to such confidential information.
>
> 3.2 The Employee shall not, either for his own account or as the representative or agent of any other person –
>
> 3.2.1. become employed or interested in any manner whatever in any business directly or indirectly in competition with the businesses carried on by the D Group; or
>
> 3.2.2 terminate this employment with the D Group;
>
> 3.2.3 furnish any information acquired as a result of his employment within the D Group, to any other person so as to result in any employee employed within the D Group becoming employed by or directly or indirectly interested in any business referred to in 3.2.1.
>
> 3.3 The Employee shall not at any time while he is employed in any capacity within the D Group and for a period of two years as from the date of termination of such employment, for any reason whatever, be interested or engaged whether directly or indirectly and whether as proprietor, partner, shareholder, director, employee, agent, consultant of otherwise, in any firm, business

[15] The submission by Mr Solomon that the payments in the three documents were cumulative appears to confirm the continuing validity and operation of the 1992 agreement.

or undertaking which carries on either solely or in conjunction with any other party any activity in competition with any business conducted by the D Group in any part of the Republic of South Africa as it was constituted on 31 May 1960, Botswana, Lesotho, Namibia, Swaziland and Zimbabwe.

3.4 The restraints set out in this clause 3 shall apply both during the entire period of the Employee's employment within the D Group and for a period of two years after the termination of such employment for any reason whatever.

3.5 The Employee agrees that each of the restraints set out in this clause 3 –

3.5.1 shall be separate and divisible and if any such restraint is or becomes unenforceable for any reason whatever, then that restraint shall be severable and shall not effect the validity or enforceability of any other restrains contained in this clause 3.

3.5.2 is reasonable and is necessary, given the nature of the businesses conducted within the D Grouup, and the competitive environment in which such businesses are conducted, so as to afford such businesses legitimate protection in respect of the trade secrets and confidential information concerning such businesses which have been and which will be acquired by the Employee during the period of his employment within the D Group."

61. One looks in vain to the 1996 and 1998 agreements to see what further right or asset the taxpayer undertook to exchange or surrender or sterilise to earn any further consideration which could be characterised capital in nature. The test indicated by Watermeyer CJ in CIR v Lever Bros and Another 1946 AD 441 at 450 that one should look to the originating cause of receipts or ask what was the "quid pro quo which he gives in return for which he receives them" is, with respect, apposite in this case. This test was repeated and applied by Corbett AJ (as he then was) in Tuck supra at 833D: "..what was the quid pro quo which he gave for the receipt?".

62. The restraints set out in clause 3 of the 1996 agreement and the 1998 agreement are exactly the same as those set out in the 1992 agreement, save as regards the duration of the restraint upon termination of employment. The taxpayer committed himself in 1992 to the surrender of

those attributes of his economic persona as set out in clause 3 of that agreement. To repeat the same clause in 1996 and 1998 does not constitute a further surrender on his part. These capacities have already been given up. One cannot repeatedly exchange the same asset to the same person but for a different price each time.

63. The taxpayer has given up no additional resource in exchange for the further payments in 1996 and 1998. He has undertaken no supplementary restrictions on his income producing capacity.

64. This view is fortified when noting that the restraints in the 1992 agreement endured during employment and for a period of two years thereafter. However, in the 1996 agreement, the restraint period was reduced to that of six months. There was certainly no sacrifice on the part of the taxpayer. This document, on the basis of which he received the payment of R1,25 million, purported to impose a less onerous restraint period. The 1998 document did no more than confirm the restraint period of two years as set out in the still operative 1992 agreement.

65. It was never contended that the time periods of the restraint , post employment, were cumulative. Neither of the two subsequent time periods were expressed to run from expiry of the time period in the earliest or the next agreement. The trigger to commencement of these time periods was, in each case, termination of the taxpayer's employment. Such trigger never eventuated.

Greater deterrence

66. Mr Solomon argued that the taxpayer had come into into contact with and acquired knowledge of very substantial trade secrets and confidential information of the D group whose turnover had increased so considerably. Accordingly he posed a substantially greater threat to the expanded D group in 1996 and 1998 than he had in 1992. It was therefore understandable that D would wish to conclude a new restraint of trade

agreement providing for substantially higher restraint payments which the taxpayer would forfeit if he went into competition.

67. Mr Solomon, having conceded that the taxpayer continued to be restrained in 1996 and 1998 by virtue of the 1992 agreement, submitted that these subsequent documents contained within them a stronger deterrent to him entering into competition with D. The consequences of any breach of the 1992 restraints had now been financially and adversely increased. Further, these additional payments constituted a greater reward to him for not entering into competition with D on termination of emnployment

68. The difficulty with this submission is that the taxpayer relinquished nothing in exchange for these payments. He surrendered nothing at all. There is no capital loss to him as a result of which he received these payments. Absent any exchange there can be no capital receipt to him.

69. If the 1996 and 1998 payments did not constitute considerations for any asset of the taxpayer, then they are quite clearly attempts to 'top up' the 1992 consideration paid for the restraints which the taxpayer had given at that time and which still continued. Such augmentation cannot be a capital payment in exchange for restraint undertakings. Not only had such undertakings already been given four years previously but capital payments cannot be made with retrospective effect. It is a principle of tax law that expenditure must be incurred during the year of assessment. D could not therefore in 1996 and thereafter in 1998 make payments for those freedoms which had already been surrendered in the in 1992 year of assessment.

70. That the taxpayer may have had to refund these sums of money, on the happening of specified future events, did not, at that time or thereafter, create any or a greater restriction of or upon his income producing ability .

71. Whether the possibility of repayment of these monies on breach of any restraint actually constitutes a deterrent to a potentially offending restrainee is another issue which it is not necessary for this court to decide. Essentially, no retribution or penalty is extracted from the offending employee who meets no sanction from his or her own pockets. All the employee does is to refund the monies which have been paid over to him or her in advance of the breach The employee is not out of pocket in any way and is free to breach the restraints. The only deterrent or method of enforcement continues to be the common law remedies.

Charade

72. The evidence is that these were standard documents supplied by accountants to the group. The taxpayer repeated that he did not negotiate the terms thereof at all, save to indicate in 1998 that he thought he was worth R3 million.

73. It is difficult not to conclude that these documents are no more than off-the-shelf precedents recycled when further sums of money were to be paid to the taxpayer. The terms and conditions of these documents have been shown to be without force or effect. Some of the terms are empty. The documents appear to be meaningless save to provide a vehicle which apparently justified payment of the two sums of money.

74. This approach would explain why the following 'anomalies' appear. First, that the 1996 and 1998 agreements purport to exist in a vacuum as though the 1992 agreement had never been concluded, making no reference to the earlier agreement and providing no indication for what purpose any further agreement has been created. Second, there is no surrender of any aspect of the taxpayer's economic persona, as has already been discussed at length. Third, the time periods for which the restraints purport to operate are reduced in the 1996 document and reinstated in the 1998 document and the taxpayer testified that he played no part in formulating any term of these documents. Fourth, the taxpayer claims to have committed himself to a document

which purported to restrain his income-producing capability and involve substantial sums of money yet he did not understand all the terms thereof, vide his explanation that clause 4.4 was never clear to him or anyone else he asked. Fifth, by 1996 the proviso to clause 4.4 was nonsensical because he was now the MD of the company (K) and accordingly he was signing a document which purported to allow him to buy himself out after termination of his employment only on condition that he, himself, was no longer on the board. Sixth, the meaningless status of the documents may explain why the taxpayer signed the documents representing both parties to the agreement - in his capacity as a director of K (which he was) and in his capacity as an employee of K (which he was not). Seventh, if the taxpayer or someone else (such as a competitor of D group) refunded these sums of money on his departure from D then he would be free to inflict upon D the very damage which the documents purported to prevent - the 1996 document required no more than his departure from the Board since he was the director involved while the 1998 document required the departure of Mr Davies from the Board[16].

The Status of these further payments

75. For purposes of this judgment it is not required of the court that we express a definitive view as to the nature of these sums of money paid over to the taxpayer. It is sufficient to state that they are not considerations in exchange for undertakings of restraint of trade.

76. The further issue as to the true nature of these payments was not fully argued by either party.

77. We have had regard to the evidence that third parties were interested in securing the services of the taxpayer and the concern of the investors in ensuring the continuing services of the taxpayer within the D group.

[16] This is suggestive of a director's tie-agreement which was not argued and which is not pursued.

78. It is conceivable that the payments made were to induce the taxpayer to remain in the employ of the D group. They may be an attempt to persuade the taxpayer not to leave, not to cross over to the competition or to become the competition. In such case, the 1996 and 1998 payments would be retainers. They would be an attempt to hold the taxpayer in place, to more firmly secure his exclusive services. In such case, they may have been payments made with an eye on future competition but that does not render them payments in exchange for an undertaking of Restraint of Trade. In receiving these monies the taxpayer suffered no further loss of trading or economic freedom. That the equivalent of the retainer might have to be refunded meant no more than that there was an attempt to reward continuing loyalty and penalise future disloyalty.

79. It is also conceivable that these payments might have been considered in the nature of bonuses paid to recognise services already rendered in the course of employment and the contribution which the taxpayer had made in the past to the growth and apparent profitability of the D group. Lump sum amounts paid in recognition of prior services may be made ex contractu or ex gratia. However, such a bonus is not in terms refundable because repayment would be repugnant to the nature of a bonus in recognition of past performance and could not be conditional upon future events. One would therefore not expect any amount to be paid by the taxpayer in the event that he entered into activity in breach of a Restraint of Trade to be linked to a bonus already paid in recognition for past performance. There could be no link by way of quantum of the sum to be paid or the condition of payment of such penalty.

80. Whether these payments were to secure future services or rewards in recognition of past services, all of which would fall into the definition of ‘gross income’, this court is not called upon to decide.

CONCLUSION

81. The full court finds that the sum of R 350 000 (three hundred and fifty thousand rand) accrued to the taxpayer pursuant to the 1992 Restraint of Trade agreement. This portion of the 1996 assessment of the Commissioner is therefore set aside and referred back to the Commissioner.

82. The full court finds that the sum of R 1,25 million (one million two hundred and twenty five thousand rand) which accrued to the taxpayer, purportedly pursuant to the 1996 agreement, and the sum of R 3 million (three million rand) which accrued to the taxpayer, purportedly pursuant to the 1998 agreement, were not made pursuant to a Restraint of Trade. The appeals in respect of these sums are disallowed and the income tax assessments for 1998 and the relevant portion of 1996 are confirmed.

DATED AT JOHANNESBURG 10th AUGUST 2005

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K Satchwell - President

On behalf of Mr W B Cronje (Accounting Member) and Mr V A Jiyane (Commerical Member) and myself.

Date of Hearing: 2nd and 4th August 2005

For Commissioner: Ms A Mohamed

For the Taxpayer: Adv P Solomon SC,

Adv G D Goldman

Instructed by Cyril Ziman & Associates