REPORTABLE

IN THE TAX COURT OF SOUTH AFRICA
HELD IN CAPE TOWN

BEFORE :

The Honourable Mr. Justice B. Waglay:		**President**
Mr. B. Nduna	**:**	**Accountant Member**
Mr. J. Kevitt	**:**	**Commercial Member**

CASE OF

NO: 11454

(Heard in Cape Town on 24 August 2005)

J U D G M E N T

1. The Appellant was incorporated in terms of the Companies Act No. 25 of 1892 on 9 May 1924, under the name A Company of Africa Limited. The designation "(Proprietary)" was inserted in the Appellant's name on 4 March 1955 pursuant to section 6(3) of the Companies Act No. 46 of 1926 as amended by Act No. 46 of 1952.

2. Some 35 years later, on 2 July 1959, the Appellant changed its name to B Southern Africa (Proprietary) Limited, pursuant to the passing of a special resolution.

3. Since the incorporation of the Appellant to date, C plc (registered in England and Wales under registration number X) has been and continues to be the controlling shareholder of the Appellant. The Appellant was a wholly owned subsidiary of C plc until October 2001. Since October 2001 C plc has held 75% of the Appellant's shares.

4. On 24 October 1979 and pursuant to a special resolution passed by the Appellant on 22 October 1979, the Appellant amended paragraph 1 of its memorandum of association by adding the following to it:

> *"The corporate name B Southern Africa (Proprietary) Limited is adopted and used by permission of (C) Limited. On withdrawal of that permission B Southern Africa (Proprietary) Limited will cease to use such name and will immediately change its corporate name and trading name so that neither includes the mark ("B") or any trade mark, trade name, name or other mark of ownership belonging to (C) Company Limited, or any other trade mark, trade name, name or other mark of ownership likely to be confused therewith."*

5. The Appellant operates as a manufacturer, supplier and marketer of certain products in South Africa. Its operations consist of five separate business segments, namely (i) retail; (ii) commercial/industrial; (iii)

specific contracts (iv) other supplies; and (v) international supply and trading (IST).

6. The Appellant purchases products from abroad and manufactures these products in South Africa in E. The latter is a cost centre division of the Appellant operated as a joint venture between the Appellant and F, a company operating within the same economic sphere as the appellant.

7. The Appellant sells and distributes, both nationally and elsewhere in Africa, its products that have been manufactured by it, or purchases from one of the other commodity companies in South Africa in terms of swap arrangements in place between the companies, or purchases under spot contracts from various international suppliers (which occasionally would include G International Limited, a subsidiary of C plc). On occasion, the Appellant also purchases at arm's length prices products from C plc's trading arm in H.

8. The Appellant also supplies the other commodity companies in South Africa with products in terms of the specific arrangements referred to above.

9. The Appellant is one of a number companies that dominate the specific market in South Africa. Each of these companies conducts its operations under a brand name, which they either own or are licensed to use. The

Appellant (like some of the others) uses brands owned by its overseas holding company.

10. C plc, Appellant's holding company is the worldwide owner of the trade mark (**the licensed marks**) and the trade dress, colour scheme, designs and symbols (**the licensed marketing *indicia*)** used by the Appellant.

11. The Appellant commenced using the licensed marks in or about 1959. Since 1959 and until an agreement was concluded in 1997 between the Appellant and C plc the Appellant used the licensed marks by agreement with C plc free of any payment. The use of the licensed marks was only reduced to writing in 1965. Two further written agreements were concluded thereafter, the last on 24 October 1979 (the 1979 agreement).

12. In terms of the 1979 agreement:

    12.1 The Appellant's license to use the licensed marks was a non-exclusive one and subject to the provision that C plc could at any time give notice to the Appellant to enter into negotiations towards the conclusion of an agreement for the payment of a royalty for the use of the licensed marks;

12.2 If such negotiations did not lead to the conclusion of an agreement on the royalty, the 1979 agreement would terminate;

12.3 Both the Appellant and C plc were given the right to terminate the 1979 agreement subject to notice. In such event, the Appellant was required to cancel its recordal as a registered user and to refrain from using the said licensed marks or any other mark or marks which might be confused therewith in relation to any goods or services which the Appellant provided.

13. In and during 1996 C plc decided that users of its licensed marks and the licensed marketing *indicia* should be required to pay a royalty. To this end it commissioned an independent company to determine the value of its licensed marks and licensed marketing *indicia*. This study identified the role played by the brand in the various business segments in which Appellant was involved. Based on this information calculation was made in respect of the profit actually generated by each segment which could be attributable to the licensed marks.

14. Relying on the study referred to above C plc concluded that different brand royalty payments were required to be paid by the different business

segments in relation to products sold, given that the brand impacted differently on the profitability of each business segment.

15. Pursuant to the aforementioned report of the investigations C plc concluded a written trademark license agreement with the Appellant in 1997 (the 1997 agreement). The relevant terms of this agreement are summarized as follows:

 15.1 The agreement would commence on 1 January 1997 and would endure for a period of two years. Thereafter it would be automatically renewed for succeeding twelve-month periods, unless terminated earlier by either of the parties giving the other 6 months notice, or by reason of some breach as provided for in the agreement;

 15.2 The Appellant was granted a personal non-exclusive and non-assignable authorization to use the licensed marks and the licensed marketing *indicia;*

 15.3 C plc remained the sole rightful owner of the licensed marks and licensed marketing *indicia*, and all rights and goodwill attaching or arising out of the use by the Appellant thereof accrued to the benefit of C plc; and

15.4 Upon termination of the agreement, the Appellant would no longer be entitled to use the licensed marks and the licensed marketing *indicia* in respect of any goods or service which it supplied or rendered.

16. A further consequence of the termination of the 1997 agreement would be that the Appellant would no longer be entitled (in the absence of the conclusion of a further agreement with C plc) to use the name "B Southern Africa", as set out in paragraph 4 above.

17. In terms of the 1997 agreement the territory in which the Appellant was entitled to utilize the licensed marks was limited to the Republic of South Africa and in consideration for the use of the licensed marks and the licensed marketing *indicia*, the Appellant was required to pay to C plc an annual royalty fee as set out in the investigation report referred to above.

18. In terms of schedule B to the 1997 agreement the royalty fee was expressed as a rate per measurement of product sold by the (i) retail; (ii) commercial /industrial; and (iii) other supplies business segments. The rates for each of the mentioned business segments were calculated on the basis of the impact of the brand on that business segment. No royalty was payable in respect of products sold by a certain business segment as the market in which it operated was (and is) driven by price and availability and not brand. Royalty was also not payable in respect of the IST

business segment as this segment's activities and profitability were not linked to the use of the brand.

19. When concluding the 1997 agreement, the Appellant and C plc *bona fide* considered that the royalty fee specified in the 1997 agreement was fair and reasonable remuneration for the right of use accorded to the Appellant under the agreement.

20. On 3 November 2000, the Appellant and C plc agreed to amend schedule B to the 1997 agreement and in so doing, amended the rates for each business segment for 1998 and 1999.

21. According to the Appellant, it concluded the 1997 agreement and paid the brand royalty for the following reasons:

21.1 Most of the Appellant's competitors in the South African market operated under and made use of well-established, international brand names and marks.

21.2 The name of B, the licensed marks and licensed marketing *indicia* were well established in the South African market and continued use thereof would:

21.2.1 Enable the Appellant to continue to differentiate the products it manufactured and marketed from the products marketed by its competitors under the other brand names;

21.2.2 Enable the Appellant to avoid the very significant costs of re-branding itself and its products;

21.2.3 Enable the Appellant to take advantage of the reputation which it had established over the years with the use of the licensed mark and licensed marketing *indicia* in South Africa;

21.2.4 Enable the Appellant to build on the reputation which it had established over the years with the use of the licensed mark and licensed marketing *indicia* in South Africa, enhancing its customer loyalty and consequently increasing its sales; and

21.2.5 Accordingly, attract customers thereby maintaining and enhancing the Appellant's profit, and maintaining and increasing the Appellant's market share.

22. It is accepted by the Respondent that the conclusion of the 1997 agreement has in fact resulted in the Appellant attaining the advantages set out in paragraph 21.2 above.

23. Consequent upon the above the Appellant made the following royalty payments during the relevant years of assessment:

1997	:	R40 190 000;
1998	:	R45 150 000; and
1999	:	R42 519 000.

24. The Appellant then claimed a deduction of the above amounts in calculating its taxable income in its Income Tax Returns for the years 1997, 1998 and 1999.

25. The Commissioner, the Respondent, issued an assessment disallowing the deduction of the royalties in calculating the taxable income. The Appellant has objected and appealed against the disallowance of the deduction.

26. The issue for determination is thus whether the expenditure incurred in terms of the agreement between the Appellant and C plc is deductible in terms of s 11 (a) of the Income Tax Act 58 of 1962 (The Act) or, more specifically whether the deduction sought by the Appellant is prohibited because the expenditure constitutes an expenditure of a capital nature.

27. Section 11 (a) of the Act provides as follows:

> *"**11. General deductions allowed in determination of taxable income.** – For the purpose of determining the taxable income derived by any person from carrying on any trade, 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;"*
>
> *(b) …*

28. The Appellant contends that the payment to C plc for the use of its licensed marks and licensed marketing *indicia* constituted an expenditure of a non-capital nature in the hands of the Appellant for the following reasons:

    28.1 Ownership of the licensed marks and the licensed marketing *indicia* vested with C plc;

    28.2 The Appellant obtained no enduring benefit as the contract was/is terminable on six months notice;

    28.3 The costs to procure the use of the licensed marks and the licensed marketing *indicia* are recurrent annually.

29. Mr Meyerowitz SC, assisted by Mr Rogers SC, likened the Appellant's position *vis-à-vis* C plc to that of a tenant and landlord where the annual

royalty payments constitute nothing other than rental paid for the use of another's property.

30. Whilst it is true that what was being paid for was the use of licensed marks and licensed marketing *indicia*, the nature and effect of the property paid for differs from mere rental in two significant aspects. Firstly, without these marks and the *indicia,* the Appellant would not be in a position to trade. Appellant itself concedes that it wanted a well-established, international brand name and mark. It sought to remain in the market as an international brand and particularly one that had a well-established market in South Africa in order to retain existing customers and attract new ones and to thus maintain and grow its market share. In addition, the use of the marks and *indicia* meant that Appellant did not have to incur the very significant costs of re-branding itself and its product. To compare these factors with a good trade location within the context of a landlord and tenant presupposes that a single location is indispensable to the success of its enterprise. The contract concluded by the Appellant to use trademarks in its business must be viewed within the context of the Appellant's business.

31. Secondly, the nature of the property itself differs. A trademark is a result of the intellectual application of one's mind, and has to be specific and unique. A fixed asset is different. A feature of a trademark is that it must be distinctive and capable of being distinguished from all other marks. A

fixed asset does not need to be classified as distinctive in order to be an asset. A trademark connects the goods with the person using it; it gives identity to the user thereof. A fixed asset on its own does not give identity to its occupant. In addition, a trademark carries with it a reputation associated with the product, whilst a fixed asset carries with it no such reputation.

32. In this instance, for reasons I set out later, the trademark gives the Appellant structure and goodwill, without which it would be unable to continue its operations in the form and style it does. The rental of a building however does not give structure and goodwill. If a lease was terminated, Appellant would be able to move to another building, without its structure or goodwill being affected.

33. Appellant's counsel further averred that royalty payments for use of incorporeal property such as trade marks, patents and copyright can never constitute expenditure of a capital nature since "if it were, one would expect to find many reported judgments on the subject". In the same vein it was argued that the complete dearth of authority in South African, English and Australian law is "eloquent testimony to the uncontentious nature of the deduction sought". Whilst some weight may attach to this, it cannot in itself lead the Court to rush to the Appellant's aid.

34. The Respondent on the other hand argued that in order to establish whether or not the expenditure incurred by the Appellant is one constituting capital or revenue, the court should enquire into the purpose of the expenditure. In this respect it referred to the matter of **CIR v Genn & Co (Pty) Ltd** 1955 (3) SA 293 (A) at 299G where the court held that:

> *"In deciding how the expenditure should properly be regarded the Court clearly has to assess the closeness of the connection between the expenditure and the income-earning operations, having regard both to the purpose of the expenditure and to what it actually affects."*

35. The above dictum can be supplemented by having regard to the discussion on capital expenditure in the **Australian Income Tax Law and Practice Guide**, par 51/055 p 2004.88.12, where the following two extracts from their case law are cited as illustrations of the distinction between outgoing of a capital nature and outgoing of a revenue nature:

> *"What is a outgoing of capital and what is a outgoing of revenue depends on what the expenditure is calculated to effect from a practical and business point of view, rather than upon the juristic classification of the legal rights, if any, secured, employed or exhausted in the process."* (**Hallstrom Pty Ltd v FCT** (1946) 3 AITR 436; 72 CLR 634 at 648)

And further at p 2004.88.13 it is recorded:

> *"In **Hallstroms'** case as in **BP Australia Ltd v FCT**, it was known that advantage was sought by the taxpayer from expenditure, and the question was whether an expenditure made to secure an advantage of that kind has the character of capital or income. In other words, the question in dispute was not, 'What was the expenditure for?', but, 'Was the advantage, known to be sought by the expenditure, of a capital or revenue nature? It was held that in answering that question the nature of the advantage from a practical and business point of view had to be considered."*(**FCT v South Australian Battery Makers Pty Ltd** (1978) 8 ATR 879 at 887; 140 CLR 645 at 659).

36. This approach has been followed by our courts which are not overly concerned with a technical classification of a right or benefit in determining the nature thereof. The **Hallstrom** case (*supra)* has also been referred to with approval in the case of **SARS v Kajadas Cosmetics (Pty) Ltd** 2002 (4) SA 709 (T) 64 SATC 200 at 203 which dealt with the issue of classification of expenditure as capital in nature.

37. Applying the above approach to the present matter, from a practical and business point of view, the nature of the advantage sought by the Appellant in terms of the Trademark Licence Agreement is set out in paragraph 21 above. The factors listed there do not however lend themselves to reflexively determine whether the expenditure is of a capital or revenue nature.

38. In **SIR v Cadac Engineering Works (Pty) Ltd 27 SATC 61 1965 (2) SA 511 (A)** at 63 it was said:

> *"It is clear that the object of capital expenditure in a business is normally to earn income or profits or to increase the income or profits of the business. Thus the mere fact that the expenditure by the owner of the business is intended to produce income or results in income being earned, does not mean that the expenditure for that reason alone is to be classed as revenue expenditure…"*

39. While the distinction between capital and revenue expenditure is clear conceptually, it is not as easy to discern practically. In **Rand Mines (Mining & Services) Ltd v CIR** 1997 (1) SA 427 (A) the court with reference to a number of well-know Appellate Division tax cases stated:

> *"An abiding problem has been to identify and then synthesise into a reasonably accurate and universally applicable yardstick the factors which are indicative of each of the two classes of expenditure. No such yardstick has yet been fashioned and the attempt has come to be regarded as futile and has been abandoned. Instead, the courts have identified useful indicia to which regard may be had, emphasising that they are no more than that and that in each case close attention must be given to its particular facts. In* ***Commissioner of Taxes v Nchanga Consolidated Copper Mines Ltd*** *[1964] 1 All ER 208(PC) at 212B–D ([1964] AC 948 at 959) Viscount Radcliffe warned against the notion that any of the indicia identified by the courts, taken singly, will always lead to the right conclusion. He said:*

'. . . (A)ll these phrases, as, for instance, "enduring benefit" or "capital structure" are essentially descriptive rather than definitive, and, as each new case arises for adjudication and it is sought to reason by analogy from its facts to those of one previously decided, a Court's primary duty is to enquire how far a description that was both relevant and significant in one set of circumstances is either significant or relevant in those which are presently before it.'

40. Our courts have evolved some useful tests in order to further aid in distinguishing between capital and revenue expenditure. One such test is set out in the well-known quote from **CIR v George Forest Timber Co Ltd** 1924 AD 516 :

"There is a great difference between money spent in creating or acquiring a source of profit, and money spent in working it. The one is capital expenditure, the other is not."

41. Relying on the above dicta, the Respondent argued that the right of use of the trademarks obtained in terms of the Trademark Licence Agreement did not in itself produce income and that the successful utilisation in the business of the Appellant of the trademarks before any income is produced is what is relevant. Respondent argued that the Appellant needed the license to use the trademark before it could operate its business and as such the Appellant was clearly obtaining a source of income in return for the annual payment for use of the trademarks, as opposed to incurring expenditure in working a source of profit. These submissions by the Respondent are misconceived. The Appellant did not require the trademarks to operate its business. Its business was already in operation. What it sought was to retain and build the business it already

operated. This it could only do by entering into the Trademark Licensing Agreement.

42. The Respondent further referred this court to the decisions in **Rand Mines (Mining & Services) Ltd v Commissioner for Inland Revenue** 59 SATC 85 (1997 1 All SA 427 (A) and **U-Drive Franchise Systems (Pty) Ltd v Drive Yourself (Pty) Ltd and Another 1976 (1) SA 137 (D)** and argued that the royalty payments made by the appellant are no different to payments made in respect of franchise agreements, which payments constitute capital and not revenue expenditure. In the matter of **Rand Mines** the court considered a deduction of a payment made to secure a management contract. Respondent relies particularly on page 93 and 94 of the judgment which records as follows:

On page 93:

> *"The appellant's stock-in-trade is the management services which it provides. The acquisition of the management contract merely obliged Lefko to allow the appellant to render to it its management services. In other words, the expenditure resulted in the creation of a particular income earning opportunity for the appellant which it otherwise would not have had."*

And on page 94:

> *…when one asks whether the expenditure was to acquire something which added to the income earning structure of the business as opposed to expenditure routinely occurring in the running of the appellant's business, the answer which commends*

itself to one as being correct is that it was to acquire an asset which added to the income-earning structure of the business. Without such contracts, appellant would have no opportunity of doing that which generates its income, namely managing mines. The contracts in themselves generate no income but they do provide appellant with the opportunity of generating income by providing the management services for which payment will be made. They are assets of a capital nature which constitute part of the income-earning structure of the appellant. In my view, they are comparable in principle with franchise agreements, the cost of acquisition of which is not regarded as revenue expenditure."

43. In **U-Drive Franchise Systems** the court defined 'franchise' as:

> *"those 'chain style' operations in which the owner of a national brand product or service, subcontracts to permit a local dealer or person to use his brand name and agrees to provide advertising and know-how services, equipment and other benefits to the franchisee for the purpose of running the business."* (At page141)

44. The Respondent thus argued that the Trademark Licence Agreement concluded by the Appellant did not in itself produce any income, but that it created a valuable opportunity for the Appellant to earn income; the annual payment had to be made, irrespective of whether or not the Appellant earned any profit for the year. Such expenditure, argues Respondent, is comparable with the cost of acquisition of a franchise agreement, which expenditure is of a capital nature. This argument is of some merit. The Appellant only trades under the trademarks obtained under the Trademark Licence Agreement. Its operations are conducted

and regulated substantially through the agreement. The contract in issue is a vital component of the Appellant's operation, without which its business or trading prospects are limited in that there is no guarantee that it could maintain previous levels of business or survive in the market at all. The fact that it sought to continue its operation as it did in the past rather then re-create itself and to that end was now required to pay for the privilege does not to my mind make the payments an expenditure revenue in nature. This expenditure is akin to expenditure incurred in setting up a business and as such it is an expenditure of a capital nature.

45. The use of the B trade name is the primary element in the Appellant's business plan. It provides the whole structure of the Appellant's profit-making apparatus and as such the contract, albeit terminable on six months notice, does appear to constitute an asset to the Appellant.

46. In **CIR v African Oxygen Ltd** 1963 (1) SA 681 (A), 25 SATC 67 the court held that expenditure incurred in acquiring and or retaining an asset is more likely to be of a capital nature. In that matter the taxpayer, in order to prevent a foreign company from competing with it, entered into an arrangement that involved the creation of a third company which incurred losses, which losses the taxpayer undertook to make good. The taxpayer's attempt to claim these losses as a deduction met with failure, the court holding that the benefit it secured through its right to prevent

competition was an actual asset constituting a benefit of a sufficiently enduring nature and therefore capital in nature.

47. Appellant's response was that the expenditure in issue had neither added any asset to Appellant's income earning structure, nor was it intended to and therefore the expenditure had to be revenue in nature. This is met with the following dictum from the matter of **Cadac** (*supra*) where on page 75 the court held:

> *"… the mere circumstance that a payment has neither created a new asset nor made any addition to any existing asset is not necessarily conclusive in favour of such payment being a revenue expense."*

48. Although the creation of an asset is not an essential requirement, the fact that the expenditure does have the effect of creating an asset, points in the direction of capital expenditure. Assets encompass both tangible and intangible items and the right of use of the B trade name is clearly a valuable asset of Appellant's business.

49. In **CIR v Manganese Metal Co (Pty) Ltd** 1996 (3) SA 591 the court stressed that there is no single infallible test to determine if an expenditure is of a capital nature or not, but that each case has to be decided upon its own facts. The court there however pointed out (at page 600) that a helpful yardstick to determine capital as opposed to revenue expenditure is the 'enduring benefit' test. This test was extracted from **British**

Insulated and Helsby Cables Ltd v Atherton AC 205 All ER 623 which records:

> *"But when an expenditure is made, not only once and for all, but with the view to bringing into existence an asset or advantage of 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."*

50. The court in **Manganese Metal Co.** also went on, at page 605/6, to approve the dictum from **Inland Revenue Commissioners v Adam** 14 TC 34 which said:

> *'The point is similar to one which was raised and decided in **Robert Addie and Sons Collieries Ltd v Inland Revenue** 8 TC 671, where I endeavoured to state the true issues thus – Are the sums in question part of the trader's working expense, are they expenditure laid out as part of the process of profit-earning; or, on the other hand, are they capital outlays, are they expenditures necessary for the acquisition of property or of rights of a permanent character the possession of which is a condition of carrying on the trade at all?"*

51. The contract in **African Oxygen** (supra) was concluded for an initial five-year period, after which it was terminable by either party by six month's notice. In this respect the court said:

At page76:

> *"…it is evident from the terms of the agreement itself that the parties contemplated the possibility that it would continue for an indefinite period… The extent of the advantage which accrued to the respondent should, I consider, be determined in relation to the position at the inception of the agreement, which was also the inception of the advantage …"*

And at p 77:

> *"It is not unlikely, moreover, that any advantage gained during that period by way of a stabilized or increased goodwill, would not lapse at the end thereof, but would, although to a gradually diminishing extent, persist for some time thereafter."*

And further at p 78:

> *"The payments, in whatever year they were made, were for an asset which came into existence once and for all at the inception of the agreement, and the liability to make them was undertaken in order to secure the advantage of the asset for the full term of the agreement."*

52. Relying on the above dicta the Respondent argued that the payments made by the appellant were made to obtain a right or advantage of an enduring benefit to the appellant's trade; it is of a permanent character, the possession of which is essential to carrying on its trade. From the terms of the agreement it is clear that the parties envisaged at the outset that the agreement would be for an initial period of not less than two years and would thereafter continue until either of the parties gave the other six

months notice. This, I agree, does recommend itself towards capital expenditure even though its future existence is uncertain. The mere fact that the annual payment only confers a benefit upon the Appellant for a limited period, cannot convert a capital payment into revenue. Support for this is found in the matter of **CIR vs VRD Investments (Pty) Ltd 1993(4) SA330(C)** at 378 where the court recorded the following:

> *"Mr Broomberg, who appeared for the respondent, submitted that any expenditure, even one which would ordinarily be of a capital nature, will be treated as revenue if the benefit it provides endures for less than a year. I cannot agree. …,I cannot accept that the limited duration of a benefit flowing from a obviously capital expenditure would be sufficient on its own to convert, in effect, the expenditure to one which is not of a capital nature."*

53. Having regard to the case law as set out above and in particular to paragraph 21 where the appellant sets out and records the *raisons d'etre* for entering into the agreement it did, then the following is evident:

    53.1 Appellant sought an international brand name because its competitors made use of international brand names;

    53.2 The licensed marks and licensed marketing *indicia* were well established and carried significant goodwill which was built up by the Appellant over the years, and which gave the Appellant a distinct identity and reputation;

53.3 Without the brand name Appellant would be unknown and therefore without market share and goodwill and would under these circumstances have to create a new identity and distinctiveness in the market at a substantial cost without any guarantee of success.

54. By concluding the Trade Licence Agreement in order to "attract customers thereby maintaining and enhancing the Appellant's profit, and maintaining and increasing the Appellant's market share" the Appellant incurred the expenditure to protect and promote the core of its business, namely, its structure and the identity it has had for a considerable time. The Appellant's need to retain the licensed marks and licensed marketing *indicia* was to protect and increase the goodwill and the market share established by the marks and the *indicia.*

55. The expenditure thus incurred by the Appellant, although protracted and calculated according to sales, was expenditure directed to retain market share, name and reputation, old customers and competition on a footing equal to the other major players within the industry in South Africa. As such, the expenditure relates to an income earning structure rather than to income earning operations. The Agreement concluded between the Appellant and its parent company has the effect of preserving and enhancing the Appellant's market share and securing for it an advantage

by virtue of a well-established reputation and must therefore form part of its income earning structure.

56. Where expenditure is incurred in acquiring or recovering a share in the market such expenditure has to be capital in nature. In paying for marks and *indicia* that carry market share the appellant secured for itself the competitive advantage of participating in a market as an established business enterprise. The payments made therefore, irrespective of the mode of calculation, must be of a capital nature.

57. The fact that the payment is labeled a royalty does not detract from the fact that it may be capital in nature. In the case of **ITC** 1365 45 SATC 27 at page 32 the court found that a cession of a mining lease, where payments by the taxpayer to the cedent for the cession included 20% royalty payments, remained expenditure of a capital nature, as it did not detract from the nature or purpose of acquiring an income producing concern.

58. The manner in which the royalty payment was calculated, namely as a percentage of volume sold, does not automatically connect the payment to Appellant’s operations. The basis of calculation as a percentage of volume sold is simply used to determine the portion of an asset which is attributable to the goods sold. It is merely a basis of costing the expense of the asset.

59. The fact that the expenditure is of a recurrent nature cannot either detract from being capital in nature. It is also immaterial whether the asset itself (in this instance the trademarks and *indiciae*) belongs to the Appellant or not. In the case of **A v Commissioner of Taxes** 19 SATC 29 the taxpayer erected buildings on farming property which he leased from the owner. In considering whether the cost of erecting the buildings was deductible the court found as follows at p 33:

> *"The benefit created by the expenditure must, in each case, be related to the trade itself. During the currency of the lease, the appellant's 'trade' is, inter alia, that of a tobacco farmer; during that time he will enjoy the benefits resulting from the buildings he has erected, and the right to the enjoyment of the benefits created by their presence upon the farm is unquestionably his property. I cannot see how ownership of the buildings could increase the benefits or the appellant's enjoyment of them. The right to the enjoyment of the benefits forms part of the appellant's fund of capital assets and of the equipment of the income-producing machine. I conclude, therefore, that it is immaterial that he does not own the corporeal assets from which the benefits flow."*

60. The fact that in this matter the benefits flow from the right of use of incorporeal assets does not change the fact that the right clearly forms part of the Appellant's capital assets.

61. The Appellant's submission that the expenditure incurred by it should be seen as nothing other than rental in respect of fixed property is, as I have stated earlier, misconceived. The Trademark Licence Agreement is more akin to a franchise or trading licence, payment of which in circumstances as obtains in this matter, is of a capital nature.

62. The consideration paid in terms of the Trademark Licence Agreement enabled the Respondent to trade in its economic sphere with a valuable brand. The payments made were made with the purpose of maintaining and growing market share. The agreement was crucial as it is the foundation and pre-requisite of any entitlement to conduct the Appellant's business in the manner and form that it conducts its business.

63. The payments in issue are thus in substance a purchase price for a business which gave a substantial market share in the defined area, similar to a franchise agreement. The payments made to obtain these rights must therefore by its very nature be a capital expense.

64. In the statement of agreed facts it is recorded that the price of (the products in which Appellant trades) are fixed. As a result, the only way

that the Appellant can distinguish its products from its competitors is by its brand. Brand is thus the nucleus to secure and guarantee the Appellant a market share.

65. Having regard to what I have said above I am satisfied that the expenditure incurred by the Appellant in paying for the licensed marks and the licensed marketing *indicia* are expenses which are capital in nature and the Respondent was thus entitled to disallow such expense as it properly did.

In the result the appeal against the assessment is dismissed.

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WAGLAY J