Republic of South Africa

IN THE TAX COURT OF SOUTH AFRICA

(HELD AT THE WESTERN CAPE DIVISION: CAPE TOWN)

Case No: IT 14240

B Appellant

and

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE Respondent

Court: Judge J I Cloete
Heard: 28 August 2017
Delivered: 3 November 2017

JUDGMENT

CLOETE J:

Introduction

[1] This is an appeal by the taxpayer against additional assessments raised by SARS for its 2011 to 2014 years of assessment. They arose from SARS' refusal of deductions claimed by the taxpayer as allowances in respect of future expenditure (for refurbishing and/or upgrading) in terms of s 24C of the Income Tax Act ('*ITA*').[1]

[1] Act 58 of 1962 as amended.

[2] The matter came before this court as a stated case.[2] The taxpayer's appeal also involves the application of s 11(d) of the ITA for these years of assessment. The parties however agreed to separate the issues and deal only with the s 24C dispute at this stage. A separation order was granted.

[3] The questions of law in relation to s 24C are whether:

3.1 The income received by the taxpayer from operating its franchise businesses includes or consists of any amount received or accruing to it in terms of the relevant franchise agreements; and

3.2 The expenditure required to refurbish or upgrade is incurred by the taxpayer *'in the performance of the taxpayer's obligations under such contract'* as envisaged in s 24C.[3]

[4] In the stated case the parties agreed that the facts relevant to the dispute are as follows:

4.1 The taxpayer is a franchisee operating certain *'chain'* restaurants in terms of various franchise agreements between itself and the franchisor. The terms of the franchise agreements are virtually identical, and the copy annexed to the stated case may be considered to reflect the terms of all of them;

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2 As envisaged in rules 33(1) to 33(3) of the uniform rules, read with rule 42(1) of the rules promulgated under s 103 of the Tax Administration Act 28 of 2011.

3 Paras 1.17 and 1.18 of the stated case.

4.2 Clause Q1.1 of the franchise agreement provides that the taxpayer irrevocably undertakes that at all times its main object and sole business shall be the operation of the specified restaurants;

4.3 The taxpayer is obliged, in terms of clause J.2 of the franchise agreement, to pay a monthly franchise and service fee to the franchisor in respect of each of the restaurants operated by it of 5% of gross sales less any VAT attributable thereto, subject to a minimum fee of R25 000 per month which shall escalate by CPIX compounded annually; and

4.4 In terms of clause L.1.4 of the franchise agreement, the taxpayer is required to upgrade and/or refurbish the restaurants at reasonable intervals as determined by the franchisor.[4]

[5] Section 24C was introduced by s 18 of the Income Tax Act 104 of 1980.[5] During the 2011 to 2014 years of assessment, s 24C read as follows:[6]

> *'(1) For the purposes of this section, "future expenditure" in relation to any year of assessment means an amount of expenditure which the Commissioner is satisfied will be incurred after the end of such year –*
>
> *(a) in such manner that such amount will be allowed as a deduction from income in a subsequent year of assessment; or*

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4 Paras 1.12 to 1.16 of the stated case.
5 SARS' heads of argument fn 70.
6 Section 24C was amended by the Taxation Laws Amendment Act 25 of 2015 which commenced on 8 January 2016.

(b) in respect of the acquisition of any asset in respect of which any deduction will be admissible under the provisions of this Act.

(2) If the income of any taxpayer in any year of assessment includes or consists of an amount received by or accrued to him in terms of any contract and the Commissioner is satisfied that such amount will be utilised in whole or in part to finance future expenditure which will be incurred by the taxpayer in the performance of his obligations under such contract, there shall be deducted in the determination of the taxpayer's taxable income for such year such allowance (not exceeding the said amount) as the Commissioner may determine, in respect of so much of such future expenditure as in his opinion relates to the said amount.

(3) The amount of any allowance deducted under subsection (2) in any year of assessment shall be deemed to be income received by or accrued to the taxpayer in the following year of assessment.'

[Emphasis supplied].

[6] The crux of the dispute lies in whether or not the income received by the taxpayer from sales of meals to its customers can properly be regarded as arising directly from – or put differently, accruing in terms of – the franchise agreement itself. The taxpayer maintains that it can whereas SARS maintains it cannot.

[7] Allied to this is whether there is a high degree of certainty that the taxpayer will incur future expenditure in order to refurbish or upgrade its restaurants in compliance with its obligation under the franchise agreement. The taxpayer says that this is the case, whereas SARS contends that the obligation to incur such expenditure is subject to fulfilment of a suspensive condition which in turn renders the expectation itself conditional.

[8] The determination of this dispute involves consideration of the relevant terms of the franchise agreement[7] and how s 24C should be applied to it.

The franchise agreement

[9] As previously stated clause Q1.1 obliges the taxpayer to operate the restaurant in question as its sole business. Significantly, clause T.16 entitles the franchisor to cancel the agreement if the franchisee fails to actively operate that business.[8] Accordingly failure by the franchisee to do so constitutes a material breach, and an obligation is thus imposed on the taxpayer in terms of the franchise agreement itself to actively provide meals to its customers (which constitutes its sole business in terms of that agreement). The income generated from the sale of those meals is of course the same income that accrues to the taxpayer.

[10] During argument Ms Hawkins, who appeared for SARS, placed reliance *inter alia* on an extract from the taxpayer's audited financial statements for 2013 and 2014[9] where it was stated that:

> *'According to the franchise agreement the company is required in terms of a contract, at reasonable intervals as determined by the franchisor to revamp the restaurant. When the expenditure is incurred, it is recognised for accounting purposes under property, plant and equipment. The expenditure will be financed by internally generated funds and bank borrowings.'*

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7 During argument the parties did not restrict themselves to the specific clauses of the franchise agreement referred to in the stated case, nor did they suggest that the court was limited by those particular clauses.

8 Dossier p330.

9 Note 23 Dossier p364 and Note 21 Dossier p387.

[11] She fairly conceded however that *'bank borrowings'* would have to be repaid and, in all probability, from funds generated from the sale of meals to customers, given that this is the sole business which the franchisee is permitted to conduct in terms of the franchise agreement. Moreover it is reasonable to accept that the source of the *'internally generated funds'* is the income received from the sale of meals.

[12] Clause E.5 supports the inference that an obligation is imposed on the taxpayer to actively provide meals to its customers. It stipulates that:

> *'The Franchisee agrees that it will at all times, faithfully, honestly and diligently perform its obligations hereunder and that it will continuously exert its best efforts to promote and enhance the business of the Restaurant and all other restaurants in the…Restaurant Group."*[10]

[13] Also relevant are the number of clauses in the franchise agreement which dictate to the taxpayer the branded products it must use, how its restaurant must be constructed in accordance with the franchisor's requirements, how its staff is to be trained, supervised and even replaced at the franchisor's election, the prices that it can charge, the monthly franchise fee payable, that it must maintain the restaurant in such manner as determined by the franchisor, upgrade and/or refurbish it (more about this below), play only pre-recorded music approved by the franchisor, only offer food and beverage items approved by the franchisor, operate during business hours specified by the franchisor,[11] and contribute to the franchisor's marketing fund in the manner specified.[12]

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[10] Dossier p304.
[11] Subject to the terms of the franchisee's lease in terms of clause L9, Dossier p317.
[12] Clauses E, F, G, J, L and M, Dossier pp303 – 320.

[14] The franchisee is also obliged to disclose a host of financial information on a regular basis to the franchisor, including sales figures, profit and loss statements, balance sheets, VAT invoices and returns and income tax returns. The franchisor is even entitled to access to *'…any information on any computer system (including point of sale systems) utilised from time to time for the purposes of the conduct of the Restaurant'.*[13]

[15] Such is the extent of the franchisor's control over the income generating operation of the franchisee that it even has the right to interview the franchisee's customers, without prior notice to the franchisee, to determine whether it is complying with its obligations.[14]

[16] It is thus clear that the restaurant cannot be operated by the franchisee, and its income earned, other than strictly in accordance with the franchise agreement. As submitted by Mr Emslie SC (who together with Ms Rogers appeared for the taxpayer), it is no exaggeration to say that the franchisor exercises almost absolute control over the taxpayer via the franchise agreement. Although Ms Hawkins referred to clause I.1 which records that the agreement does not create a fiduciary relationship, special agency, joint venture or partnership, and that the franchisor and franchisee *'shall be independent contractors'*[15], it is plain from the franchise agreement read as a whole that this recordal is directed at protecting the franchisor from liability *vis-a-vis* the franchisee's creditors, and has no bearing on the grip of

[13] Clause N, Dossier p321.
[14] Clause O, Dossier p322.
[15] Dossier p309.

control which the franchisor has over the franchisee, including the manner in which it generates its income in terms of the franchise agreement.

[17] Clause L.1.4 provides that the franchisee agrees:

> *'…to upgrade and/or refurbish the Restaurant at reasonable intervals determined by the Franchisor to reflect changes in the image, design, format or operation of…*[the franchisor's restaurant chain]*…from time to time and required of new…franchisees subject to approval by the franchisor of detailed plans and specifications for all construction, repair or refixturing in connection with such upgrading or remodelling…'*[16]

[18] The taxpayer submits that there is nothing conditional about the obligation imposed on it under this clause: the words *'subject to approval by the franchisor of detailed plans and specifications'* do nothing more than give the franchisor absolute control thereover.

[19] On the other hand SARS argues that this clause only imposes a conditional obligation on the franchisee because the franchisor must first approve the upgrades and/or refurbishments before the taxpayer incurs any expenditure in respect thereof. It contends that the words *'subject to'* determine that the obligation is conditional only, and performance is suspended until the condition is met.

[20] In its rule 31 statement SARS raised this issue as follows:

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[16] Dossier p314.

'…is there an obligation on the Appellant in terms of the franchise agreements to incur expenditure to refurbish or upgrade the establishments…'[17]

[21] The uncontested retort of the taxpayer in its rule 32 statement was that:

'The contents of this subparagraph are denied. The Appellant avers that it has not at any stage hitherto been disputed by the Respondent that there was an obligation on the Appellant in terms of the franchise agreements to incur expenditure in order to "revamp" the restaurants operated by it.'[18]

The explanatory memorandum

[22] This memorandum was published at the time when s 24C was introduced into the ITA.[19] The relevant portion of clause 18 thereof reads as follows:

' *CLAUSE 18*

Allowance in respect of future expenditure on contracts: Insertion of section 24C in the principal Act

This clause inserts in the principal Act a new section, section 24C, empowering the Commissioner to make a deduction, by way of a reserve, in respect of any amount received under a contract which is to be utilised to finance future expenditure. The reserve allowed in one year of assessment is to be included in the taxpayer's income for the next year of assessment, when a new reserve will, if necessary, be calculated for that year. The new section caters for the situation which often arises in the construction industry and sometimes in manufacturing concerns, where a large advance payment is made to a contractor before the commencement of the contract work, to enable the contractor to purchase materials, equipment etc. In a number of instances such advance payments are not matched by deductible expenditure, resulting in the full amounts of the advance payments being subjected to tax.'

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[17] Para 23.2, Dossier p254.
[18] Para 24, Dossier p277. Ms Hawkins in her heads of argument at para 8 specifically submitted that the rule 31 and 32 statements *'should be read into the Heads of Argument as if specifically traversed'*.
[19] SARS heads of argument para 77.

The interpretation note

[23] SARS published an interpretation note on s 24C on 29 July 2014.[20] The relevant portions of the interpretation note read as follows.

[24] Advance income is defined as follows:

> ‘● *“advance income” means income, received by or accrued to a taxpayer under a contract, that will be used to finance the expenditure still to be incurred in fulfilling the taxpayer’s obligations under that contract;…’*[21]

[25] Paragraph 2 reads as follows:

> *‘2. Background*
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> *The nature of a taxpayer’s business may be such that the taxpayer receives amounts under a contract that will be used to finance expenditure to be incurred in the future in performing under that contract…*
>
> *Although Section 24C was originally intended for taxpayers entering into building and manufacturing contracts, it does not mean that the section cannot be applied to taxpayers entering into other types of contracts. In ITC 1697* [(1999) 63 SATC 146 (N) at 155] Galgut J *stated the following:*
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> > *“The fact that the allowance might have been intended for building contractors does not mean, however, that it is not available to others. On the contrary, by the particular wording of s 24C the types of trades that the individual taxpayer might carry on, and the types of contracts concerned, are in no way limited. The sole question is whether the provisions of s 24C otherwise apply…”*
>
> *Section 24C has been and can be applied to businesses in industries other than building and manufacturing provided the detailed requirements of the*

[20] SARS interpretation note number 78.
[21] Preamble to interpretation note.

section are met. For example, the section has been applied to the motor industry, the financial services industry, publishers and share block schemes…'

[26] Paragraph 4.1.1 deals with the meaning of a contract, and reads as follows:

*'**4.1.1 A contract***

Section 24C requires that the amount of income must be received by or accrued to a taxpayer under a contract. The word "contract" is not defined in the Act and therefore the ordinary meaning of the word must be applied. A "contract" is defined in the Law of South Africa [LAWSA volume 5(1) para 370] *as –*

> *"[a]n agreement entered into with the intention of creating an obligation or obligations"…*

…A taxpayer wishing to invoke section 24C must be able to prove the existence of a contract, the income received or accrued under that contract, the associated performance obligations and the expenditure related to performing those obligations, to the satisfaction of the Commissioner…'

[27] Paragraph 4.2.1(b) deals with the meaning of *'will be incurred'* for purposes of s 24C as follows:

*'**(b) Will be incurred in a subsequent year of assessment***

*Applying the expenditure principles discussed in **4.2.1(a)** to section 24C, taxpayers will need to demonstrate that an amount will be outlaid or expended in the future, or that an unconditional legal liability to outlay or expend an amount will be incurred, before the Commissioner will be satisfied that expenditure will be incurred in a subsequent year of assessment.*

The words "will be incurred" indicate that the Commissioner must be satisfied that there is a high degree of probability and inevitability that the expenditure will be incurred by the taxpayer. A taxpayer must therefore be able to demonstrate that, although the expenditure is contingent at the end of the year of assessment in

question, there is a high degree of certainty that the expense will in fact be incurred in a subsequent year.

The position was explained in ITC 1601 [(1995) 58 SATC 172 (C) at 179] *as follows:*

> *"Counsel for the Commissioner, in my view, correctly contended that the Commissioner will not be satisfied that future expenditure will be incurred where there is only a contingent liability. There must be a clear measure of certainty as to whether the expenditure in contention is quantified or quantifiable. The* onus *that the appellant bears here is to satisfy the Commissioner that the agreements relied upon will lead to deductible expenditure, in the following year. The appellant's contention that the use of the word 'will' relates only to time and not to the certainty of the expense, cannot in my view be correct. Since a deduction is sought, this must arise from an obligation and must be quantifiable.*
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> *It was also, in my opinion, correctly submitted that s 24C was not enacted to provide a deductible reserve fund for possible 'comebacks', unforeseen contingencies or latent defects in the* res vendita*. This would be contrary to the provisions of s 23(e) of the Act…*
>
> *…*
>
> *S24C is an exception to the general rule and as such the court, having regard always to its specific ambit is entitled to take a strict rather than a liberal view in its application to the facts in issue. The Commissioner, provided he too has full regard to the available facts, is entitled to adopt the same approach in exercising his discretion."*

The facts and circumstances of each case vary significantly and it is therefore not possible to specify the industries or particular circumstances in which taxpayers will always be able to demonstrate and prove the required level of certainty. The facts of each case are critical. However, the degree of certainty required is unlikely to be met if the performance is not *contractually obligatory but is only* potentially *contractually obligatory because of an act or event other than just the taxpayer's client or customer taking action. This position is phrased as follows in* Income Tax in South Africa [in 11.11.7, Authors David Clegg and Rob Stretch]*:*

> *"It is submitted that there must be in existence an enforceable and uncontingent obligation to perform under a contract, which performance will lead to the incurral of expenditure."*

The distinction can be a fine one, for example, in the case of a construction contract under which a builder is contractually required to build a house which includes tiling the floors (that is, performance is obligatory) the cost of the tiles will be included in the future expenditure calculation. The degree of certainty required to satisfy the Commissioner that the expenditure will be incurred exists in such a situation. The fact that the client has not yet decided on, for example, the colour of the tiles at the end of the year of assessment does not per se *disturb the degree of certainty although it may affect the quantification of the amount of future expenditure if the cost of the tiles is dependent on the colour chosen.*

Generally an obligation to perform remains unconditional when performance is merely dependent on a client taking action (for example, the client choosing the colour of the tiles) but not when performance is dependent on further events which may or may not occur…

At a principle level, whether the costs are variable or fixed or of an operational or infrastructural nature is not critical; what is important is that the costs flow from an unconditional obligation to perform under the contract which gave rise to the advance income and that the Commissioner is satisfied that the expenditure will be incurred in a subsequent year of assessment. Each case must be considered on its own facts…'

[Emphasis supplied].

[28] Paragraph 4.2.1(c) deals with the "same contract" issue and reads as follows:

*'**(c) In performing the taxpayer's obligations under the contract in terms of which the income was received***

The future expenditure must be incurred by the taxpayer in the performance of the taxpayer's obligations under the same contract as the contract under which the income was received by or accrued to the taxpayer. [ITC 1667 (1999) 61 SATC 439 (C); ITC 1697 (1999) 63 SATC 146 (N) and ITC 1527 (1991) 54 SATC 227 (T).*The contract does not have to (and rarely will) stipulate the exact expenditure that the taxpayer will incur. However, the taxpayer's obligations under the contract must be*

apparent or determinable and it is the expenditure which the taxpayer will incur in performing and meeting those obligations which is of relevance…'

[29] Therefore according to SARS itself:[22]

29.1 The applicability of s 24C is not limited to building and manufacturing contracts only, but depends on the nature of the business and the contract concerned;[23]

29.2 *'Contract'* has its ordinary meaning, namely an agreement entered into with the intention of creating an obligation or obligations;

29.3 The taxpayer must demonstrate that an amount will be outlaid or expended in the future or that an unconditional legal liability to outlay or expend an amount will be incurred; and

29.4 *'Will be incurred'* means a high degree of probability and inevitability that the expenditure will be incurred by the taxpayer in a subsequent year.

Meaning of key words and phrases

[30] Section 24C(2) refers both to *'in terms of'* and *'under'* the contract. In *Oosthuizen and Another v Standard Credit Corporation Ltd*[24] the Supreme Court of Appeal stated that:

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[22] With reference also to the authorities cited in the information note.

[23] It is thus not dependent on a *'class privilege'* as was contended by SARS, but is available to all taxpayers who are obliged to incur future expenditure under contracts in terms of which they earn their income, provided of course that the requirements of s 24C are met.

'The phrase "in terms of" is one which is in common use. It was argued on behalf of Standard Credit that in addition to its ordinary meaning it has a wide meaning – namely "pursuant to" or "in accordance with", and that in the proviso it bears the wide meaning. In my opinion, the three phrases "in terms of", "pursuant to", and "in accordance with" are synonyms with slightly different shades of meaning. One or other may be appropriate depending on the context, but essentially they do not differ in meaning. The dictionary meaning of the phrase "pursuant to" is "consequent on and conformable to", and that of "in accordance with" is "in conformity with". Similarly "in terms of" contains the idea of "in conformity with".

The difficulty in the present case, as I see it, is not in regard to the meaning of the expression, but in regard to what are the possible sources of information for determining whether the purpose stated in s 2(l)(a) is "in terms of" *a credit agreement. One obvious source is the agreement itself. Another possible source is evidence of circumstances prevailing at the time of the conclusion of the agreement, from which a tacit or implied term may be inferred. There may be other possible sources…'*

[31] In *Registrar of Pension Funds and Another v Angus NO and Others*[25] the following was said:

'[3] The appeal, as I see it, turns on the interpretation of "in terms of". The expression constitutes, in effect, a linking preposition. It can have the narrow meaning of "by", in the sense that the fund owes its existence to the agreement, or the wide meaning of "pursuant to" or "in accordance with". The Afrikaans equivalent used in the original version of section 2(1) was "ooreenkomstig". Currently it is "ingevolge". That there is a great degree of synonymity in these various expressions (and other common alternatives), depending on context, appears from the judgments in the Oosthuizen *and* Slims *cases. The narrow meaning conveys an immediate or direct link between the published agreement and the fund. The wide meaning conveys a looser or indirect connection.'*

[Emphasis supplied].

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[24] 1993 (3) SA 891 (A) at 900J-901C.
[25] [2007] 2 All SA 608 (SCA) at para [3].

[32] In *Slims (Pty) Ltd and Another v Morris NO*[26] Botha JA, who concurred with the majority, considered the meaning of the word *'under'* in the following context:

> *'Hence the crucial enquiry is whether the right in question is to be regarded as a "right under the lease" in terms of s 37(5) ---"enige reg wat bestaan kragtens die huurkontrak…'*[27]
>
> [Emphasis supplied].

[33] After reviewing the authorities, he found as follows:

> *' In my view the word "kragtens" is clearly capable of bearing different shades of meaning. Used as a link word, connecting two concepts, it is capable of connoting varying degrees of closeness between the one concept and the other. In a narrow sense, at the one end of the spectrum, it may be used to denote a direct and immediate connection between the two concepts linked by it ("uit krag van", "luidens"). In a wide sense, at the other end of the spectrum, it may connote no more than a loose and indirect relationship between the two concepts ("ten gevolge van", "uit hoofde van"). In this sense, where the connected concepts involve notions of cause and effect, or origin and result, I have no doubt that the word can embrace an indirect relationship, as well as a relationship in which the cause, or origin, is not necessarily the sole cause or origin of the effect or the result respectively. In this sense the word could, I consider, be rendered appropriately as "voortspruitend uit". It is of interest to note that in the Afrikaans-English dictionaries the word "kragtens" is given* inter alia *the following equivalents (apart from "under"): "by virtue of", "in consequence of", and "pursuant to" (see eg Bosman, Van der Merwe and Hiemstra* Tweetalige Woordeboek*, and Hiemstra and Gonin* Drietalige Regswoordeboek*). Similarly, the English word "under" has different shades of meaning. Some of the meanings ascribed to it in the cases are: "in terms of", "in accordance with", "in compliance with", "in pursuance of", "by virtue of", and "pursuant to" (see* Warmbaths Municipality v Friedman and Another *1949 (4) SA 183 (T) at 187;* Commissioner of Taxes v Haysom *1965 (1) SA 67 (SRA) at 70B;* Minister of Home

[26] 1988 (1) SA 715 AD.
[27] At 732C.

Affairs v Badenhorst *1984 (2) SA 13 (ZS) at 16F; and Saunders* Words and Phrases Legally Defined sv *"under"). In its wide meaning the word is certainly not confined, in my view, to the designation of a direct or exclusive connection between the two matters which it serves to link to each other."*[28]

[Emphasis supplied].

Causal link

[34] In Neethling *et al* Law of Delict[29] it is stated that:

'The method employed by the courts in practice, although frequently expressed in the terminology of the conditio sine qua non*, is the obvious one, i.e. to inquire whether one fact follows from another. This is indeed the natural way to determine a causal link.'*

And further:[30]

'Factual causation concerns a particular kind of link or connection between at least two facts or sets of facts, i.e. the link existing when, stated succinctly, one fact arises out of another.[31]In other words, if fact X is a reason why fact Y exists, or exists in a particular form, or has come into existence at a particular time, it may be said that X is a factual cause of Y…

The existence of a factual causal chain must therefore be demonstrated in view of the proved relevant facts. A test for factual causation therefore depends on the facts of each case and is not something of a general nature that can be applicable to all factual complexes…'

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28 At 733B-G.
29 7th Edition at p185.
30 At p195.
31 See *Lee v Minister of Correctional Services* 2013 (2) SA 144 (CC).

[35] Also relevant for present purposes is what was held in *Commissioner for Inland Revenue v Widan*[32]:

> *'For the purposes of this judgment I shall assume in favour of the respondent that in applying the words "by reason of" one has to ascertain what is the proximate cause. When one seeks the "proximate cause" of a certain result, it does not necessarily follow that a cause nearest in point of time is the proximate cause. On this point I can not do better than quote what LORD SHAW of Dunfermline said in* Leyland Shipping Co. Ltd. v. Norwich Union Fire Insurance Society Ltd., 1918 A.C. 350 at p.369:
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> *"To treat proximate cause as if was the cause which is proximate in time is…out of the question. The cause which is truly proximate is that which is proximate in efficiency. That efficiency may have been preserved although other causes may meantime have sprung up which have not yet destroyed it, or truly impaired it, and it may culminate in a result of which it still remains the real efficient cause to which the event can be ascribed."'*

Principles of interpretation

[36] The proper approach to interpretation was set out by Wallis JA in *Natal Joint Municipal Pension Fund v Endumeni Municipality*:[33]

> *'The present state of the law can be expressed as follows: Interpretation is the process of attributing meaning to the words used in a document, be it legislation, some other statutory instrument, or contract, having regard to the context provided by reading the particular provision or provisions in the light of the document as a whole and the circumstances attendant upon its coming into existence. Whatever the nature of the document, consideration must be given to the language used in the light of the ordinary rules of grammar and syntax; the context in which the provision appears; the apparent purpose to which it is directed and the material known to those responsible for its production. Where more than one meaning is possible each possibility must be weighed in the light of all these factors. The process is objective, not subjective. A sensible meaning is to be preferred to one*

[32] 1955 (1) SA 226 AD at 233D-G.
[33] 2012 (4) SA 593 (SCA) at para [18].

that leads to insensible or unbusinesslike results or undermines the apparent purpose of the document…'[34]

Discussion

[37] It is convenient to start with the argument of SARS. It contends that in terms of the "framework" of s 24C(2) it is an absolute prerequisite that only one contract must exist from which income is earned or received, and from which an obligation is created to incur future expenditure.

[38] It argues that in the present matter there are two contracts. The first is the franchise agreement which creates the right for the taxpayer to establish and operate the restaurants under the franchise licence and trademark of the franchisor in exchange for payments, i.e. franchise fees. The second is the day-to-day sales of meals by the franchisee to customers who in turn pay for them, to which the franchisor is not a party. There are thus, so it is submitted, two separate contracts which are legally independent and separate from each other; no income is received by or accrues to the taxpayer in terms of the franchise agreement; no future expenditure is incurred in terms of the sales transactions to customers; and therefore s 24C does not apply.

[39] As previously stated SARS also submits that what makes the taxpayer's obligation to incur future expenditure conditional are the words *'subject to'* approval by the franchisor of detailed plans and specifications when the taxpayer is obliged to carry out the upgrades and/or refurbishments. As I understand it, SARS does not suggest

[34] See also *Glen Anil Development Corporation Ltd v Secretary for Inland Revenue* 1975 (4) SA 715 AD at 727E-H and *Commissioner, South African Revenue Service v Marshall NO and Others* 2017 (1) SA 114 (SCA) at para [24].

that the taxpayer's obligation to incur expenditure at reasonable intervals determined by the franchisor is itself a conditional obligation, but it is only the fact that the franchisor must approve the plans and specifications that renders the obligation conditional. As Ms Hawkins put it in her heads of argument:

> *'Accordingly, until such time that the building plans and subsequent suppliers to perform the upgrading and refurbishments are approved by the franchisor, the upgrade and refurbishment is suspended.'*[35]

[40] On the other hand the taxpayer submits that while it is so that it receives income from its customers due to sales of meals, the fact of the matter is that it cannot provide these meals, and thereby earn its income, absent the franchise agreement. It thus argues that the franchise agreement is the *fons et origo* of the taxpayer's income, and herein lies the clear, direct causal link.

[41] As previously stated the taxpayer also contends that the words *'subject to'* in clause L.1.4 do not render its obligation conditional, but simply place absolute control over the approval of plans and specifications in the hands of the franchisor.

[42] Counsel were not able to refer me to any decisions dealing pertinently with the application of s 24C to a franchise agreement such as that in the present matter. SARS relied on the following cases.

[43] In ITC 1527[36] the taxpayer carried on the business of a furniture retailer under the slogan *'your two year guarantee store'*. It claimed the benefit of s 24C in respect of

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[35] At para 63.
[36] 1991-54 SATC 227.

insurance premiums that it collected on behalf of the insurance company providing the guarantee. Provision was made in its customer contracts for the inclusion of the insurance premiums in the calculation of the principal debt owing under each such contract. It also incurred expenditure in having to collect any defective furniture to have it repaired in terms of the guarantee, but did not know in what year the expenses would be incurred.

[44] Apart from the slogan in the heading of each contract there was no reference whatsoever to a guarantee in the body thereof. Moreover the instalment sale conditions on the reverse side imposed no obligation on the taxpayer other than to insure the goods. Apart from that the contract only conferred rights on the taxpayer.

[45] It was held that it was clear from an examination of the contract in question that no obligations were imposed on the taxpayer in terms of the contract itself for the items of expenditure claimed, and in particular that any obligation under the separate guarantee was not an obligation under the contract. Although the taxpayer might have had obligations under the Usury Act 73 of 1968, they did not arise from the contract and were imposed by the nature of the taxpayer's business and the manner in which it was conducted.

[46] In the present matter the taxpayer's failure to sell meals to its customers constitutes a material breach which entitles the franchisor to cancel. The obligation to sell meals thus appears in the body of the same contract containing the taxpayer's obligation to incur future expenditure.

[47] In ITC 1667[37] the taxpayer's claim for a s 24C allowance was based on certain copying machine rental and maintenance agreements with its customers. The equipment was typically let for a period of 60 months against payment of monthly rental. The rental agreement provided that the maintenance of the equipment did not form part of the rental agreement *'…but shall be covered by a separate maintenance agreement'*.

[48] The maintenance agreement was recorded in a separate document and, save for a special charge for excess copies, the customer paid no separate charge for maintenance of the equipment. This was instead covered in the rental agreement. The rental was discounted by the taxpayer under a cession to a third party, with the effect that the taxpayer received income in one lump sum in advance, as it were, but remained liable for maintenance of the equipment over the 60 month period of the lease.

[49] The court assumed, without deciding, that the taxpayer's future expenditure under the maintenance agreement was sufficiently certain to meet the criterion of *'will be incurred'*, and that the rental and maintenance agreements constituted one single contract for purposes of s 24C. However it found that it was not helpful for the taxpayer to describe the discounting agreement as an integral part of the scheme; nor did it assist to look at the causal relationship between the various agreements, since the legislature did not use the word "scheme" or even "transaction" in s 24C, the operative concept being a "contract".

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[37] 1999-61 SATC 439.

[50] Referring to the requirement that the expenditure must have been incurred by the taxpayer in the performance of its obligations in terms of the same contract as that under which income was received, it held that the income was received in each individual case under the discounting agreement, whereas the future expenditure was to be incurred under the maintenance agreement. Accordingly there were two separate agreements with two different parties and they were legally independent and separate.

[51] The court's reasoning was more particularly that:

> *'The cession agreement between appellant and B contains no reference to the maintenance agreements whatsoever. It seems quite clear from its terms that the rights of B pursuant to the cession agreement are not affected in any way by the performance or non-performance of the maintenance agreements by appellant.'*[38]

[52] To my mind what distinguishes the contractual arrangement in the present matter is the obligation imposed on the taxpayer, by necessary inference, in the franchise agreement to sell meals to its customers. Although the customers are not parties to that agreement, the proximate cause of those sales is that obligation.

[53] In ITC 1667 on the other hand, no obligation was imposed on the taxpayer in the maintenance agreement to enter into the discounting transaction under threat of a failure to do so constituting a material breach thereof. The sales of meals to customers are therefore, as I see it, not part of a scheme or transaction, but a

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[38] At para [11] p443.

component of an obligation integral to the same contract under which the obligation to incur future expenditure is imposed.

[54] What was also implicitly recognised in ITC 1667 is that there does not physically have to be one contract document in order to give rise to the s 24C benefit, hence the court's assumption that the rental and maintenance agreements constituted one single contract for purposes of the application of s 24C.

[55] In ITC 1890[39] the taxpayer conducted the business of managing and administering retirement villages and their frail care centres. It would enter into a contract with a seller and purchaser of a unit whereby it undertook to pay various expenses[40] of the purchaser by way of a subsidy to the body corporate from a levy paid to it by the purchaser; and also became entitled to a certain percentage of the enhancement value of the unit on its disposal by the seller. The taxpayer contended that its acceptance of the future obligation to pay the subsidy on behalf of the purchaser entitled it to the benefit of s 24C by deducting that expenditure as an allowance against the "enhancement" accruing to it from the seller. The parties referred to the contract in which the purchaser acquired a unit as the "second contract", and the one in which the seller disposed of the unit as the "first contract".

[56] The tax court agreed with SARS that the enhancement accrued to the taxpayer in terms of the "first contract" whereas the obligation to pay the subsidy was imposed in terms of the "second contract". It reasoned that they were not sufficiently linked for the taxpayer to permissibly deduct the expenditure (the subsidy) as an

[39] 2016-79 SATC 62.
[40] In respect of insurance, maintenance, security, common electricity and water etc.

allowance against the enhancement for purposes of s 24C. In particular it found that:

> *'It seems that the only connection that arises between the two agreements is that the conclusion of the second contract merely activates the application of clause 17 in the first contract in terms of which the 40% enhancement value is payable by the seller who made that undertaking to the appellant. The mere conclusion of the second contract which has an effect of triggering a consequence in the first contract cannot mean without more that the two agreements are inextricably linked.'*[41]

[57] In the present matter the sale of meals is not triggered by the conclusion of the franchise agreement in the sense that such sales are merely an independent, separate consequence thereof. If that were the case the franchise agreement would not contain a clause that a failure by the taxpayer to sell meals to its customers is a material breach entitling the franchisor to cancel. Put bluntly, no sales means no franchise agreement at the franchisor's sole election.

[58] An additional factor is that every aspect of the "contract" between the taxpayer and its customers is dictated by the franchise agreement between the taxpayer and the franchisor. In other words the franchise agreement intrudes into every aspect of the taxpayer's generating of its income.

[59] Applying the principles in *Endumeni* I am persuaded that, given the language used in the franchise agreement; the context and apparent purpose to which s 24C is directed; the interpretation note; and the authorities to which I have referred on key

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[41] At para [26].

words and phrases, the franchise agreement and the sales of meals to customers are inextricably linked. They are not legally independent and separate.

[60] This interpretation, to my mind, leads to a sensible meaning and is to be preferred to one that would undermine the apparent purpose of the franchise agreement. It thus follows that I am persuaded that the income is earned, for purposes of s 24C, under the same contract as the taxpayer's future expenditure will be incurred.

[61] I am not persuaded that the words *'subject to'* in clause L.1.4 result in the imposition only of a conditional obligation as far as incurring future expenditure is concerned. The primary obligation is that such expenditure will be incurred at reasonable intervals determined by the franchisor. In my view the existence of an unconditional primary obligation cannot be rendered conditional by the precise manner in which that obligation is to be performed. There can be no question (and indeed SARS does not contend this) that the performance of the primary obligation carries a high degree of probability and inevitability. Merely because the franchisor gets to choose "the colour of the tiles" as it were, does not detract from the unconditional obligation on the part of the taxpayer to perform. I therefore also do not agree with the argument advanced by SARS in this regard.

Costs

[62] Section 130(1)(a) of the Tax Administration Act 28 of 2011 provides inter alia that a tax court may make an order for costs in favour of the successful party if the SARS grounds of assessment or "decision" is held to be unreasonable. The taxpayer

submits that it was unreasonable for SARS to suggest that the allowances claimed did not fall squarely within the provisions of s 24C of the Act.

[63] In the exercise of my discretion I do not believe that such an order is warranted in the particular circumstances of this matter. I do not consider that SARS was unreasonable in adopting the approach that it did. Each case in matters such as this is very fact specific and, from the decisions of the tax court to which I was referred, it seems clear that there is generally no easy answer to this type of debate.

[64] **In the result the following order is made:**

1. **The taxpayer's appeal succeeds.**
2. **The additional assessments raised by SARS for the taxpayer's 2011 to 2014 years of assessment are set aside.**
3. **Each party shall pay their own costs.**

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