



**THE SUPREME COURT OF APPEAL OF SOUTH AFRICA**

**JUDGMENT**

Case no: **511/2011**  
**REPORTABLE**

In the matter between:

**Stellenbosch Farmers' Winery Limited**

**Appellant**

and

**Commissioner for the South African Revenue Service**

**Respondent**

Case no: **504/2011**

In the matter between

**Commissioner for the South African Revenue Service**

**Appellant**

and

**Stellenbosch Farmers' Winery Limited**

**Respondent**

**Neutral citation:** *Stellenbosch Farmers' Winery v Commissioner for SA Revenue Service* (511/2011 and 504/2011) [2012] ZASCA 72 (25 May 2012)

**Coram:** Brand, Van Heerden and Tshiqi JJA and Kroon and Boruchowitz AJJA

**Heard:** 2 May 2012

**Delivered:** 25 May 2012

**Summary:** Revenue – whether receipt by taxpayer of a sum of money of a capital or a revenue nature - whether interest on alleged underpayment of provisional tax in respect of the receipt should have been levied in terms of s 89(3) of the Income Tax Act 58 of 1962 – whether receipt attracted value added tax in terms of s 7 of the Valued-Added Tax Act 89 of 1991 or zero rate applicable in terms of s 11(2)(i)(ii).

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ORDER

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On appeal from: Tax Court, Cape Town (Louw J with Messrs P Ranchod and B Nduna as assessors, sitting as a court of first instance).

Case no. 511/2011:

- 1 The main appeal is upheld with costs, including the costs of two counsel.
- 2 The additional assessment of the taxpayer in respect of the 1999 tax year is set aside.
- 3 The cross-appeal is dismissed with costs, including the costs of two counsel.

Case no. 504/2011:

The appeal is dismissed with costs, including the costs of two counsel.

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JUDGMENT

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KROON AJA (BRAND, VAN HEERDEN et TSHIQI JJA and BORUCHOWITZ AJA concurring):

[1] Before us are two matters that emanated from, and were heard simultaneously in, the Tax Court sitting at Cape Town (Louw J with Messrs P Ranchod and B Nduna as assessors). Leave to appeal to this court was granted by Louw J.

[2] In the main appeal in case no. 511/2011, Stellenbosch Farmers' Winery Limited (the taxpayer) seeks to attack the finding of the court a quo that the receipt by the taxpayer of the sum of R67 million during the 1999 tax year had correctly been

included by the Commissioner for the South African Revenue Service (the Commissioner) in the taxpayer's gross income in the assessment for that tax year, and had accordingly correctly been assessed to tax. The taxpayer's contention is that the receipt was of a capital nature and had therefore attracted no tax liability.

[3] In the cross-appeal the Commissioner seeks to assail the order of the court a quo setting aside the refusal by the Commissioner to direct, in terms of s 89quat(3) of the Income Tax Act 58 of 1962, that interest not be paid by the taxpayer on the unpaid provisional tax assessed to have been payable in respect of the sum of R67 million (as part of the taxpayer's gross income), and the direction of the court a quo that such interest not be paid.

[4] In case no. 504/2011 the Commissioner appeals against the order of the court a quo setting aside the assessment by the Commissioner that the taxpayer's receipt of the sum of R67 million was subject to value-added tax (VAT) at the rate of 14 per cent in terms of s 7 of the Value-Added Tax Act 89 of 1991, ie in the sum of R9 380 000 (and that in addition the taxpayer was liable to pay a penalty of R938 000 and interest in the sum of R7 804 274,09), and the court a quo's declarator that the receipt by the taxpayer of the sum of R67 million was subject to VAT at the rate of zero per cent in terms of s 11(2)(l)(ii) of the Act. The dispute between the parties centres around the issue whether the receipt of R67 million related to 'services', as defined in s 1, supplied by the taxpayer to a non-resident and not 'directly in connection with movable property situated inside the Republic of South Africa', as envisaged in s 11(2)(l)(ii).

[5] Both matters find their origin in related sets of facts (as set out in the paragraphs that follow), many of which were common cause or not in dispute.

## Background

[6] The taxpayer was a wholly owned subsidiary of Stellenbosch Farmers' Winery Holdings Limited. The latter was in turn wholly owned by Stellenbosch Farmers' Winery Group Limited. In the judgments of the court a quo the last mentioned entity was referred to as 'SFW Group', and the present judgment will follow suit.

[7] At all material times the taxpayer carried on business as a producer and importer of liquor products, and as a wholesaler of a range of spirits, wine and other liquor products to retailers. In contradistinction, SFW Group was exclusively a holding company, and did not conduct other operational business activities. Since the 1970s the taxpayer had inter alia imported and distributed Bells whisky (together with Dimple and Haig whiskies – hereinafter collectively referred to as Bells).

[8] On 1 February 1991 United Distillers plc (UD), a subsidiary of Guinness plc, both based in the United Kingdom, concluded a joint venture agreement (the JV agreement) with SFW Group and Distillers Corporation (SA) Ltd (Distillers). This agreement led to the formation of United Distillers Imports (Pty) Limited (UDI) in which SFW Group and Distillers each held a 25 per cent shareholding and UD the remaining 50 per cent.

[9] Clause 3.1 of the JV agreement provided that UD would enter into distribution agreements with the entities in South Africa appointed by UDI as distributors of UD's products (which included Bells). It was further recorded, in respect of SFW Group and Distillers, that the intention was that as far as possible the only distributors would be

the marketing companies/divisions of those two entities. Clause 3.4 reflected that the envisaged distributor of Dimple/Haig would be Monis while Sedgwick Taylor would distribute Bells. As a fact both these entities were divisions of the taxpayer.

[10] As foreshadowed in the JV agreement, a further written agreement relating to the distribution of Bells in South Africa (the distribution agreement) was concluded on 12 May 1992 between UD and an entity styled simply 'Stellenbosch Farmers' Winery'. In terms of the agreement this entity was appointed as the exclusive distributor of Bells in South Africa and surrounding territories. On the other hand, the entity undertook not to sell competing products in the area in question. The period of the distribution agreement was ten years, with effect from 1 February 1991, whereafter the agreement was terminable on 12 months' notice. Accordingly, and notwithstanding that extensions of the agreement was contemplated, it would, depending on when notice of termination was given, terminate on 31 January 2002 or on a date subsequent thereto.

[11] The Tax Court accepted, for purposes of its judgment, but without so finding, that the taxpayer was the entity which was a party to the distribution agreement. I will later return to this issue.

[12] It may be recorded at this stage however that the taxpayer did in fact undertake the role of exclusive distributor of Bells in terms of the agreement, and continued therewith until, as set out later, the distribution agreement was terminated on 28 August 1998. The venture proved to be extremely profitable for the taxpayer. Over the decades the taxpayer built up the Bells brand to the position of a pre-eminent asset in South Africa, which it did not occupy anywhere else in the world. Bells sales

contributed between 18 per cent and 25 per cent of the taxpayer's profit or 'bottom line'. This was significant for the taxpayer as the sale of spirits delivered the real profit margins (as opposed to other products). As the volumes of spirit sales was small compared to those of other products, a significant reduction in spirit sales would not bring about a significant reduction in costs, but only affect the 'bottom line'. In South Africa Bells acquired the reputation of a 'Known Value Item', which the taxpayer's other international spirit brands did not achieve. As it was put, the Bells brand 'brought feet into the retail stores' and was a valued asset to the retailer. This in turn gave the taxpayer substantial leverage and bargaining power in its dealings with retailers, and enabled it to induce them to stock, and give 'forward space' to, other products of the taxpayer (at the expense of products of competitors). After the loss of the distribution rights for Bells (as to which, see below) the taxpayer's trading income dropped very significantly, by many millions of rand, during the ensuing two financial years (whereafter the taxpayer was forced to merge with another entity to avoid bankruptcy).

[13] During 1997 certain corporate structural changes in the form of company mergers took place in the United Kingdom and Europe, involving inter alia Guinness plc and UD. One result was the formation of an entity styled Diageo Nederland BV (Diageo). The changes effected the union of the spirit and wine businesses of inter alia UD and UDI, and the distribution network of another distributor in South Africa, Gilbeys, also accrued to Diageo. The above changes entailed consequences for the liquor market in South Africa. UD accordingly sought to extract itself prematurely from the distribution agreement, and negotiations towards that end were set in train.

[14] In the result, a written agreement (the termination agreement) was concluded on 27 August 1998. Reflected as a party to the agreement was SFW Group (referred to in the body of the agreement as 'SFW'). The effective date of the agreement was 28

August 1998, ie some three years and five months before the earliest date on which the distribution agreement could have been terminated by UD giving notice as envisaged therein.

[15] Clause 4.1 of the termination agreement provided inter alia that in consideration of payment by Indivined BV (another party to the agreement) of the sum of R67 million to 'SFW', the latter and UD agreed that certain agreements would terminate. These included the JV agreement and what was referred to as the 'SFW Distribution Agreement', defined in clause 2.1 as:

'an agreement dated 12<sup>th</sup> May 1992 between UD and SFW relating to distribution by SFW of the Products in terms of which SFW was granted sole and exclusive rights to distribute the Products in the Territory'.

Also included were any other arrangements relating to the distribution of the products between UD or its affiliates and SFW or its affiliates. In terms of clause 2.1 the term 'affiliate' included a subsidiary of any party to the agreement.

[16] Clause 4.5 of the termination agreement read as follows:

'For the avoidance of doubt:-

(a) Neither SFW nor UDI will have any claim against UD or Indivined; and

(b) SFW will have no claim against UDI

for compensation for loss of distribution rights, loss of goodwill or any other loss of any kind arising from the terminations provided in this agreement and SFW acknowledges that the payments to be made to it under this Agreement represent full compensation for the closure of SFW's business relating to the Products as a consequence of the termination of the distribution rights relating to the Products.'

[17] The amount of R67 million was in due course paid to the taxpayer and its receipt was reflected in its financial statements for the 1999 tax year. It is this receipt that is the subject of the issue in the main appeal in case no. 511/2011.

### Onus

[18] In terms of s 82 of the Income Tax Act, the onus (in the Tax Court and on appeal to this court) was on the taxpayer to establish that the receipt of the R67 million was of a capital nature and that it should not have been assessed to tax as part of the taxpayer's gross income, as was directed by the Commissioner.

### Did the taxpayer acquire distribution rights and did it surrender them against payment of the sum of R67 million?

[19] A stance adopted by the Commissioner was the following. The taxpayer was not a party to the distribution agreement; it therefore acquired no rights under that agreement to distribute any products. It was therefore similarly not a party to the termination agreement and it was not paid anything in respect of the termination of the distribution rights provided for in the termination agreement. Its receipt of the sum of R67 million must accordingly have been in terms of a further agreement. What that agreement was, was not disclosed. Accordingly, there could not be any talk of the taxpayer having discharged the onus of proving that the Commissioner had erred in including the sum of R67 million as part of the taxpayer's gross income for the 1999 tax year. I did not understand Mr Emslie (who, with Mr Sholto-Douglas, appeared for the Commissioner) to press this contention. That attitude of counsel was correct.



[20] I do not think that it is necessary, as regards the distribution agreement, to consider the argument of Mr Cilliers (who, with Mr Louw, appeared for the taxpayer) that the reference to 'Stellenbosch Farmers' Winery' in the agreement was ambiguous, and therefore that evidence of identification of the entity intended was admissible, and that the evidence disclosed that the intention was to refer to the taxpayer.

[21] The following considerations dictate a finding that the taxpayer did acquire the exclusive rights of distribution provided for in the distribution agreement:

- (a) SFW Group was solely a holding company, and did not carry on any operational business activities.
- (b) The taxpayer was an operational company that was capable of implementing the distribution provisions of the agreement; indeed, it had been conducting activities of the nature in question for decades.
- (c) The JV agreement envisaged that marketing companies/divisions of SFW be appointed as distributors of the products in question. The taxpayer was such an entity.
- (d) The taxpayer did in fact assume the role of exclusive distributor of certain products as envisaged in the agreement and that regime governed the relationship between all the role players in question until the termination agreement came into effect.

[22] The judgment of the Tax Court proceeded on the premise that it was the taxpayer that surrendered the distribution rights in question, and in consideration thereof received payment of the sum of R67 million. It could suffice to comment that the premise was the corollary of the finding referred to in the previous paragraph. It may be added however that the evidence disclosed that the party with which negotiations

were held in respect of the termination of the distribution rights was in fact the taxpayer. I refer specifically to the evidence of Mr Stroebel, the managing director of the taxpayer (and of SFW Group as well), Mr van der Watt, the corporate strategy and planning manager of the taxpayer, and Mr Cardwell, the managing director of UDI. The evidence was not challenged.

Was the receipt of the sum of R67 million of a capital or a revenue nature?

[23] While the Act, in s 1, contains a definition of 'gross income', which excludes receipts or accruals of a capital nature (save for certain exceptions which are not relevant for present purposes), there is no definition of 'receipt or accrual of a capital nature'. There is no single criterion for determining whether a receipt or accrual is to be categorised as capital or income. The question falls to be decided on the facts of each particular case: see *Bourke's Estate v Commissioner for Inland Revenue*.<sup>1</sup> In *Commissioner for Inland Revenue v Pick 'n Pay Employee Share Purchase Trust*<sup>2</sup> Smalberger JA expressed himself as follows:

'There are a variety of tests for determining whether or not a particular receipt is one of a revenue or capital nature. They are laid down as guidelines only – there being no single infallible test of invariable application. In this regard I agreed with the following remarks of Friedman J in *ITC 1450* (at 76):

"But when all is said and done, whatever guideline one chooses to follow, one should not be led to a result in one's classification of a receipt as income or capital which is, as I have had occasion previously to remark, contrary to sound commercial and good sense" '.

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<sup>1</sup> *Bourke's Estate v Commissioner for Inland Revenue* 1991 (1) SA 661 (A) at 671I-J ; 53 SATC 86 at 93.

<sup>2</sup> *Commissioner for Inland Revenue v Pick 'n Pay Employee Share Purchase Trust* 1992 (4) SA 39 (A) at 56G-I.

[24] The judgment of the Tax Court sets out a tabulation of a number of the guidelines which have been recorded in previous decisions of the courts. It is not necessary in the present judgment to repeat the tabulation, and I will content myself in the discussion that follows with a reference only to those guidelines that appear to be appropriate for a resolution of the issue on hand.

[25] The starting point in my view is the finding of the court a quo that the exclusive distribution rights held by the taxpayer in terms of the distribution agreement, was a capital asset. That was the argument of Mr Cilliers in the Tax Court and the correctness thereof was conceded by Mr Emslie. In this court that common approach was persisted in. It was clearly correct and nothing more requires to be said on that score. It follows that, consequent upon the termination agreement, the taxpayer lost an asset.

[26] *Non constat* however, so the court a quo approached the matter, that the R67 million payment was of a capital nature. The approach was in keeping with the approval by Franklin J in *ITC 1259*<sup>3</sup> of the following dictum in the English case of *Inland Revenue v Fleming & Co (Machinery) Ltd (3)*:<sup>4</sup>

‘The sum received by a commercial firm as compensation for the loss sustained by the cancellation of a trading contract or the premature cancellation of an agency agreement may in the recipient’s hands be regarded either as a capital receipt or a trading receipt forming part of the trading profit. It may be difficult to formulate a general principle by reference to which in all cases the correct decision will be arrived at since in each case the question comes to be one of circumstance and degree.’

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<sup>3</sup> *ITC 1259* 39 SATC 65 at 68-69.

<sup>4</sup> *Inland Revenue v Fleming & Co (Machinery) Ltd (3)* 33 TC 33 at 63.

[27] The Tax Court held that the question to be answered was whether the taxpayer was compensated for the capital value of the exclusive distribution right, ie whether the compensation of R67 million paid for the early termination of the distribution right was paid as compensation for the loss of the value of the capital asset, the distribution right, and therefore destined to fill a hole in the taxpayer's assets, or whether it was paid as compensation for a loss of profits in the sales of Bells, which would be the result of the early termination of the distribution right.

[28] The first comment that falls to be made on the ruling of the Tax Court against the taxpayer on this score is that it implies that the receipt of the R67 million by the taxpayer was 'a gain made by an operation of business *carrying out a scheme for profit-making*', a well established guideline test considered by Smalberger JA to be the appropriate one in *Pick 'n Pay*.<sup>5</sup> That would mean however that in the present matter the taxpayer, admittedly in possession of a capital asset and treating it as such, changed its intention in respect thereof, and decided to convert its use of the capital asset (part of its income-producing structure) to use thereof as trading stock (part of its income-producing activities). For the reasons that follow I am unable to align myself with that proposition.

[29] It was held in the court a quo that in order to determine the nature of the amount paid to the taxpayer for the early termination of the exclusive distribution right, it was important to look at the bargaining position of the taxpayer and what the amount was paid for. It was pointed out that come what may there was no prospect of UD's agreeing to the extension of the agreement beyond the remaining 41 months. The

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<sup>5</sup> Fn 2 above at 56I-G. See too *SIR v The Trust Bank of Africa Limited* 1975 (2) SA 652 (A); 37 SATC 87 at 101-102.

parties therefore negotiated, and ultimately reached agreement, upon the compensation for a wasting asset with a finite lifespan. It is not clear to me however how this consideration bears on the nature of a payment admittedly made in respect of an asset.

[30] The judgment of the court a quo sought to lay emphasis on what was referred to as the taxpayer's calculations in preparing for the negotiations. The reference was to the evidence of Van der Watt, who stated during examination-in-chief that he was asked to negotiate on behalf of the taxpayer 'an amount for the termination of the contract as it had a period to run and we clearly needed to be compensated for that if it was terminated early'.

[31] That statement, so it was held, required to be seen in the context of an 'internal document' of the taxpayer, which reflected that the starting point of the taxpayer at the envisaged negotiations was to be its calculation of its loss of profits over the remaining 41 months in respect of Bells sales, plus the profits from other products associated with the sales of Bells. The judgment continues as follows:

'The final agreed compensation of R67 million mirrors this. It was made up of R42 117 000 which compensated [the taxpayer] for the projected loss of profit for the remaining 41 months. The rest of the R67 million was made up as compensation for the loss of profit from other products which [the taxpayer] would have been able to "bundle" with or "piggy-back" on the sales of Bells and R7 million, which was expressly attributable to the risk that income tax would be payable.'

[32] The above reasoning misinterpreted the evidence.

(a) While the figure reflected in the document in respect of Bells sales (excluding VAT) was R42 117 000, the total figure reflected for all sales including VAT (and inclusive of the addition of a 35 per cent premium in respect of “piggy-back” sales) was R64 818 000. Moreover, it was reflected in the document that if, despite the manner in which the transaction (ie the compensation transaction) was structured, the tax authorities were to seek to tax the proceeds, the tax liability would be R14,5 million. The amount of R67 million mirrors neither the total figure of R64 818 000 nor the tax figure of R14.5 million.

(b) In fact, the document in question, although drawn up by Van der Watt, was not produced during the negotiations nor disclosed to the other side.

(c) On the contrary, the evidence of Stroebel was that his initial offer to the other side was the sum of R100 million (the basis of this sum will be discussed below). The counter offer was R60 million. To this figure R7 million was subsequently added as a compromise sum in respect of contingent tax liability.

[33] In any event, the judgment of the Tax Court recognised that in the valuation of a capital asset it is not inappropriate to have regard to the profits anticipated from the use of the capital asset. Para 32 of the judgment (which follows on the comments about the internal document) reads as follows:

‘While the method of calculation of the amount of compensation is an important factor, it is not determinative of the nature of the receipt. This is so because: “[I]t is a normal principle of valuation of a capital asset, whether it be land or the goodwill of a business or otherwise, to use the profits expected to be earned from the utilisation of the asset as a basis or starting point for the relevant calculations” per McEwan J in *ITC 1341* (1980) 43 SATC 215 at 224; and see *Taeuber and Corssen (Pty) v CIR* (1975) 37 SATC 129 at 140; and see *CIR v Illovo Sugar Estates Ltd* (1950) 17 SATC 387 at 394.’

[34] The judgment of the court a quo then referred to what were stated to be indicators of how the taxpayer, at the time, saw and treated the amount of R67 million it received. The first were entries in the taxpayer's financial statements for the tax year in question. Two items were relevant. First, in the statement headed 'CASH FLOW STATEMENT FOR THE YEAR ENDED 30 JUNE 1999', the R67 million was reflected as an 'exceptional item' under 'cash flow from operating activities' and not under 'cash flow from investing activities'.

[35] In my judgment, counsel for the taxpayer validly argued that the nature of a receipt (ie whether it is capital or revenue) for income tax purposes, is not determined by how it is subsequently treated for accounting purposes. Reference (by analogy) was made to the decision in *Secretary for Inland Revenue v Eaton Hall (Pty) Ltd*<sup>6</sup> where it was held that accounting practice cannot override the correct interpretation of the provisions of the Act and their application to the facts of the matter. As appears from the present judgment the facts favour a finding of a capital nature. Second, not only did the financial statement reflect that the receipt of the R67 million was an 'exceptional item', but note 4 to the statement specifically recorded that the receipt was 'compensation for the cancellation of the exclusive distribution rights', which points rather to a receipt of a capital nature.

[36] The second item in the financial statements referred to by the Tax Court was an entry reflecting that a dividend of some R88 million was declared, notwithstanding that, although the taxpayer had the reserves to declare the dividend it did not have the cash on hand to meet the dividend. The point (which had not featured in the

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<sup>6</sup> *Secretary for Inland Revenue v Eaton Hall (Pty) Ltd* 1975 (4) SA 953 (A) at 958 B-D.

Commissioner's pleadings) was however adequately met by counsel's submission that the manner in which a taxpayer deals with a receipt, after it has received it, cannot determine the nature of the receipt, eg the capital nature of the receipt of the proceeds of the sale of a building is not affected by the utilisation of the proceeds to pay a dividend.

[37] The court a quo also placed reliance on the fact that the R67 million was initially paid into a dividend account of SFW Group. On the evidence of Van der Watt this was done as a matter of convenience as the taxpayer could then earn interest on the net amount in the account. The aspect is not of assistance to the Commissioner.

[38] A further ground for the finding of the Tax Court was founded on a passage in the taxpayer's statement of its grounds of appeal to the Tax Court. It read as follows: 'It was commercially more sensible for the [taxpayer] to have the [distribution] agreement terminated in 1998 upon compensation for the termination of its rights, than to have the agreement run its full term and then not have it renewed. If it became apparent, in 1998, that the [taxpayer's] right to distribute Bells . . . would not have been renewed in January 2002, this would have had a serious detrimental effect on the motivation of sales staff, leading to a reduction in income. Furthermore, the [taxpayer] had to give itself time to attempt to limit the damage that would have been caused by the loss of its distribution rights by attempting to garner other business in place of the lost products.'

Suffice it to say that this passage speaks to an intention to receive compensation for the loss of an asset, which would be used in an endeavour to replace that asset with another income-producing structure.



[39] The above paragraph leads to a consideration of earlier paragraphs in the judgment of the court a quo reading as follows:

‘The loss of the Bells distribution rights resulted in insignificant changes to [the taxpayer’s] physical business infrastructure. But a few personnel (three to four out of 3200 employees) were laid off. Bells was fully imported in bottled form and the litreage of the Bell’s products sold amounted to only 1,45 per cent of the total litreage handled by [the taxpayer]. [The taxpayer’s] infrastructure regarding production and distribution therefore remained virtually intact . . . . [The taxpayer’s] existing income-earning structure was rendered less profitable, but it remained virtually unchanged and was not removed.’

[40] However, one of the guideline tests adverted to in the court a quo, borrowed from the decision in *ITC 1341* (1980) 43 SATC 215, was whether a substantial part of the income-producing structure of the taxpayer had been sterilised by the transaction in question. It was held in that case that the impairment of 20 per cent of the taxpayer’s business was material, and compensation for such impairment by the withdrawal of a party from a joint venture agreement was held to be of a capital nature. See too the further remarks following on the quotation from *Fleming* set out in para 26 above, reading as follows:

‘When the rights and advantages surrendered on cancellation are such as to destroy or *materially* to cripple the *whole* structure of the recipient’s profit-making apparatus, involving the serious dislocation of the normal commercial organisation and resulting perhaps in the cutting down of the staff previously required, the recipient of the compensation may properly affirm that the compensation represents the price paid for the loss or sterilisation of the capital asset and is therefore a capital and not a revenue receipt.’

[41] In *Silke* on South African Income Tax, 2010 service 41, Vol 1 p 3-51, para 2.23 3.23 the following passages appear:

'An amount received by way of damages or compensation for the loss, surrender or sterilisation of a fixed capital asset or of a taxpayer's income-producing machine is a receipt of a capital nature.

. . .

In order for compensation for the cancellation of a trading contract to constitute a sum of a capital nature, it is sufficient if the contract constitutes a substantial part of the business, and the cancellation need not have the effect of destroying or materially crippling the whole of the taxpayer's income producing structure.'

See too *Commissioner of Inland Revenue v Illovo Sugar Estates Limited* 1951 (1) SA 306 (N) at 310-311.

[42] Counsel therefore correctly submitted that the court a quo's reasoning reflected that it erroneously focussed on only physical assets, instead of the much more valuable incorporeal assets constituted by the exclusive distribution rights (the loss of which, consequent upon the termination of the distribution agreement, brought in its train the disastrous consequences referred to earlier in this judgment). The compensation for the impairment of the taxpayer's business constituted by that loss is properly to be viewed as a receipt of a capital nature.

[43] In amplification of the findings of the court a quo as to the calculations that founded the settlement of the compensation to be paid, it was subsequently added that, as was admitted by Van der Watt, a notional purchaser of the distribution rights (to endure for a further 41 months) would not have paid R67 million therefor, or even R42 million. But, as against this feature is a consideration of what the negotiating parties wished to secure by settling the terms of the termination agreement. A prospect faced by UD was that during the remaining 41 months that the distribution

agreement had to run the value of the Bells brand would be seriously compromised as a result of the manner in which the taxpayer, either of its own accord or forced by circumstances, exercised the distribution right. The value of the distribution right, an asset, would be safeguarded in UD's hands. That was something worth paying for.

[44] On the other hand, Stroebel, the managing director of the taxpayer, and not Van der Watt, was the person who had finally to determine and approve the settlement. As recorded earlier, he conveyed to UD that he wanted a payment of R100 million (his main purpose being to ensure that capital was available for the acquisition of a new whiskey brand). In the result, he approved the counter offer of R60 million as supplemented by the sum of R7 million, the compromise figure in respect of a contingent tax liability. The figures were cognisably less than the projected sales profits and the contingent tax liability (if the Commissioner sought to assess any such liability). The circumstance that in the result Stroebel's endeavours to acquire a substitute brand to replace Bells met with minimal financial success is neither here nor there.

[45] Finally, it should be emphasised that clause 4.5 of the termination agreement<sup>7</sup> referred to payment of full compensation for the closure of the taxpayer's business relating to the exercise of the distribution rights (an asset). There was no reference in the termination agreement to a payment for loss of profits. There is no suggestion that the termination agreement did not reflect the intention of the parties or that it was in any way simulated. It need hardly be added that any suggestion that the taxpayer, faced with the option of concluding a capital transaction with no tax implications or an

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<sup>7</sup> Para 16 above.

income transaction with such implications, would chose the latter, is, to say the least, an unconvincing one.

[46] I find accordingly that the taxpayer, which did not carry on the business of the purchase and sale of rights to purchase and sell liquor products, did not embark on a scheme of profit-making, and that it did discharge the onus of establishing that the receipt of R67 million was of a capital nature. The Commissioner erred in including the receipt in the taxpayer's gross income and assessing same to tax. The taxpayer is accordingly entitled in the main appeal to the relevant orders set out at the end of this judgment.

#### The Cross-Appeal

[47] The issue in the cross-appeal would only have remained alive had the Commissioner been successful in resisting the main appeal. The Commissioner's failure therein renders the issue in the cross-appeal moot. The dismissal of the cross-appeal is accordingly appropriate.

#### The appeal in case no. 504/2011

[48] As recorded in para 4 above, the Commissioner determined that the receipt of R67 million by the taxpayer (a registered vendor for VAT purposes in terms of the Value-Added Tax Act 89 of 1991) was subject to VAT at the rate of 14 per cent in terms of s 7(1) of the Act. The taxpayer's appeal to the Tax Court against that determination was successful. The present appeal by the Commissioner is against the substituted order of the Tax Court that the receipt of R67 million is subject to VAT at the rate of zero per cent in terms of s 11(2)(l) of the Act.

[49] Section 7(1) of the Act provides as follows:

‘Subject to the exemptions, exceptions, deductions and adjustments provided for in this Act, there shall be levied and paid for the benefit of the National Revenue Fund, a tax, to be known as the value-added tax:

(a) on the supply by the vendor of goods or services supplied by him . . . in the course or furtherance of any enterprise carried on by him;

. . . .’

[50] It was correctly common cause both in the Tax Court and before us that the matter concerned the issue of the supply of services in the course of an enterprise, and not the supply of goods. As will appear below the issue was finally of narrow ambit.

[51] Relevant definitions in s 1 are the following:

(a) Enterprise includes:

‘any enterprise or activity which is carried on continuously or regularly . . . and in the course or furtherance of which . . . services are supplied to any other person for a consideration . . . .’

(b) A proviso to the definition of ‘enterprise’ provides that

‘anything done in connection with the commencement or termination of any such enterprise or activity shall be deemed to be done in the course or furtherance of that enterprise or activity.’

(c) Supply includes:

‘all . . . forms of supply, whether voluntary, compulsory or by operation of law, irrespective of where the supply is effected . . . .’

(d) Services include:

‘anything done or to be done, including the granting, assignment, cession or surrender of any right or the making available of any facility or advantage . . . .’

[52] Section 11(2)(l)(ii) provides as follows:

‘Where, but for the section, a supply of services would be charged with tax at the rate referred to in section 7(1), such supply of services shall, subject to compliance with subsection (3) of this section, be charged with tax at the rate of zero per cent where –  
 . . . .’

(l) the services are supplied to a person who is not a resident in the Republic; not being services which are supplied directly –

. . . .

(ii) in connection with movable property . . . situated inside the Republic at the time the services are rendered . . . .’

[53] The Tax Court found that, by agreeing to the early termination of the distribution right, the taxpayer surrendered the remaining portion of the right, and that such surrender constituted the supply of services in the course of an enterprise by the taxpayer to UD. There can be no quarrel with the correctness of these findings.

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[54] The argument of Mr Emslie was essentially the following. Accepting that UD was a non-resident of the Republic, counsel submitted that the services supplied by the taxpayer were constituted by the *act of surrender* and that the movable property in connection with which those services were directly supplied by the taxpayer was *the exclusive distribution right* provided for in the distribution agreement, now coming to an end in terms of the termination agreement, which right was situated within the Republic where it was being exercised.

[55] The argument cannot be upheld. In the first place, the distinction sought to be drawn by counsel between the act of surrender and the right surrendered is not a valid one. The question was dealt with by the Tax Court as follows:

‘. . . I do not agree with the submission that the exclusive distribution right held by the [taxpayer] can constitute the movable property as contemplated in s 11(2)(l). The services supplied by the [taxpayer] consisted of the surrender of the exclusive right. These services must be supplied *directly in connection with movable property situated inside the Republic* at the time the services are rendered. Logically there must be two separate entities: the services being supplied and the movable property which stand in direct connection with the services being supplied. I fail to see how the right which is being surrendered, the surrender of which constitutes the supply of the services, and is thus a constituent part of the services being supplied, can at the same time constitute the movable property which is required by section 11(2)(l) to be in direct connection with the very services being supplied.’ (Emphasis in original)

I align myself with this reasoning and do not feel called upon to add anything thereto.

[56] That conclusion renders it unnecessary to consider the second leg of the inquiry. I will however make the following brief comments. I agree with the finding of the Tax Court that the exclusive distribution right, which was incorporeal property, was not situated in the Republic. The *situs* of an incorporeal right is where the debtor resides. *MV Snow Delta: Serva Ship Ltd v Discount Tonnage Ltd*<sup>8</sup>. In this case the place of residence of the debtor, UD, was the United Kingdom, where it was registered. The matter therefore fell squarely within the purview of s 11(2)(l)(ii).

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<sup>8</sup> *MV Snow Delta: Serva Ship Ltd v Discount Tonnage Ltd* 2000 (4) SA 746 (SCA) paras 9-10.

[57] The taxpayer accordingly discharged the onus resting on it in terms of s 37 of the Act to establish that the supply in question was subject to value-added tax at the rate of zero per cent, and that the contrary decision of the Commissioner was wrong.

### Orders

[58] The following orders will accordingly issue:

(a) Case no: 511/2011:

- (1) The main appeal is upheld with costs, including the costs of two counsel.
- (2) The additional assessment of the taxpayer in respect of the 1999 tax year is set aside.
- (3) The cross-appeal is dismissed with costs, including the costs of two counsel.

(b) Case no: 504/2011

The appeal is dismissed with costs, including the costs of two counsel.

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F Kroon  
Acting Judge of Appeal



## APPEARANCES:

Cases: 511/2011 and 504/2011

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