



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

**JUDGMENT**

Case no: 966/2012  
Reportable

In the matter between:

**COMMISSIONER FOR THE SOUTH AFRICAN  
REVENUE SERVICE**

**APPELLANT**

and

**MOBILE TELEPHONE NETWORKS HOLDINGS (PTY) LTD**

**RESPONDENT**

**Neutral citation:** *Commissioner for the South African Revenue Service v Mobile Telephone Networks Holdings (Pty) Ltd* (966/12) [2014] ZASCA 4 (7 March 2014)

**Bench:** Ponnann, Shongwe and Wallis JJA and Van Zyl and Legodi AJJA

**Heard:** 18 February 2014

**Delivered:** 07 March 2014

**Summary:** Income Tax Act 58 of 1962 – s 11(a) read with ss 23(f) and (g) – audit fees incurred for a dual or mixed purpose – apportionment of.

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## ORDER

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**On appeal from:** South Gauteng High Court, Johannesburg (Victor J (Horn and Wepener JJ concurring)) sitting as court of appeal.

(a) The appeal is upheld with costs, such costs to include those consequent upon the employment of two counsel.

(b) The order of the court below is set aside and in its stead is substituted the following order:

- ‘(1) The appeal is dismissed with costs, including those of two counsel.
- (2) The cross appeal is upheld with costs, including those of two counsel.
- (3) The order of the Tax Court that “50% of the audit fees incurred for the 2001, 2002, 2003 and 2004 tax years is deductible from “income” (as defined) for those tax years” is amended by the deletion of “50” and the substitution therefor of “10”.’

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## JUDGMENT

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**Ponnan JA (Shongwe and Wallis JJA and Van Zyl and Legodi AJJA concurring):**

[1] The respondent, Mobile Telephone Network Holdings (Pty) Ltd (Holdings), is the holding company of five directly held and a number of indirectly held subsidiaries and joint ventures. It, in turn, is a wholly owned subsidiary of the MTN Group Limited. The collective business of the operating companies within the group is the operation of mobile telecommunication networks and the provision of related services to customers in Cameroon, Nigeria, Rwanda, South Africa, Swaziland and Uganda.

[2] Apart from the dividends it received from its subsidiaries, which were its primary source of income, Holdings also loaned funds to those subsidiaries for application in their businesses primarily on an interest-free basis. It also facilitated a group employee debenture scheme whereby it borrowed funds (through issuing the debentures) and loaned those to group companies at a higher interest rate. It thus had two sources of income – a dividend income and an interest income. Holdings had no employees of its own and conducted no other business other than those investment holding and lending activities.

[3] Holdings employed auditors to perform a statutory audit of its financial statements for each of the 2001, 2002, 2003 and 2004 tax years. The amount expended by Holdings on audit fees for each of those years was R365 505, R647 770, R427 871 and R233 786, respectively (the audit fees). In addition, during the course of the 2004 tax year Holdings paid an amount of R878 142 to KPMG in relation to, what was described in the evidence as the 'Hyperion' computer system (the KPMG fee). In its income tax returns for those tax years filed with the appellant, the Commissioner for the South African Revenue Services (the Commissioner), Holdings claimed as deductions all of the audit fees, as also the KPMG fee.

[4] The Commissioner: (a) disallowed the KPMG fee in its entirety; and (b) apportioned the annual audit fees by permitting a deduction of between two and six per cent thereof. The apportionment employed by the Commissioner in each instance was based on the ratio of Holdings' interest income as against its total revenue (ie revenue from both dividend and interest income).

[5] Its objection to the disallowance of those amounts having been overruled by the Commissioner, Holdings appealed to the Special Income Tax Court. The Tax Court (per Gildenhuys J) upheld the disallowance of the KPMG fee on the basis that it constituted expenditure of a capital nature. It also rejected Holdings' contention that the audit fees were deductible in full, holding instead that a 50/50 apportionment was appropriate. It accordingly set aside those assessments and referred the matter back to the Commissioner for re-assessment in accordance with its judgment.

[6] Holdings appealed those findings to the full court of the South Gauteng High Court. In the alternative to claiming a full deduction of the audit fees, it sought a 94 per cent deduction on an alleged time basis. The Commissioner cross-appealed the 50/50 apportionment order. The full court (per Victor J (Horn and Wepener JJ concurring)) upheld Holdings' appeal in relation to the KPMG fees – allowing that deduction in full. It also overturned the 50/50 apportionment of the audit fees and directed the Commissioner to allow for a deduction of 94 per cent thereof as contended for by Holdings. It accordingly dismissed the Commissioner's cross-appeal. The appeal to this court by the Commissioner against those findings is with the leave of the full court.

[7] Before this court, the thrust of the argument advanced on behalf of the Commissioner was that in terms of s 11(a) read with s 23(f) of the Income Tax Act 58 of 1962 (the Act):

- (a) the audit fees are deductible only to the limited extent originally allowed by the Commissioner (or to such other extent as this court may allow); and
- (b) no deduction in respect of the KPMG fee is permissible, alternatively, the KPMG fee is subject to an apportionment on the same or a similar basis to the audit fees.

[8] Taxable income is the basis upon which normal tax is levied. It is arrived at by first determining the taxpayer's gross income and then deducting therefrom any amounts exempt from normal tax in order to arrive at the taxpayer's income. The taxpayer's taxable income is then determined by deducting from the income the various amounts which the Act allows by way of deduction, including those covered by s 11(a). Section 23 prescribes what deductions may not be made in the determination of taxable income. Subsections (f) and (g) of s 23 represent, what has been described as the 'negative counterpart' of s 11(a) and, in determining whether a particular amount is deductible, it is generally appropriate to consider whether or not such deduction is permitted by s 11(a) and whether or not it is prohibited by s 23(f) and/or (g). (See *Commissioner for Inland Revenue v Nemojim (Pty) Ltd* 1983 (4) SA 935 (A) at 946H-947C.)

[9] The general deduction formula laid down in s 11(a) of the Act permits the deduction from the taxpayer's income of 'expenditure and losses actually incurred in the production of income, provided such expenditure and losses are not of a capital nature', whilst ss 23(f) and (g) of the Act prohibit a deduction in respect of:

'(f) any expenses incurred in respect of any amounts received or accrued which do not constitute income as defined in section one;

(g) any moneys, claimed as a deduction from income derived from trade, to the extent to which such moneys were not laid out or expended for the purposes of trade.'

Section 1 of the Act defines 'income' as: 'the amount remaining of the gross income of any person for any year or period of assessment after deducting therefrom any amounts exempt from normal tax under Part 1 of Chapter II'.

[10] It is well settled that 'generally, in order to determine in a particular case whether moneys outlaid by the taxpayer constitute "expenditure incurred in the production of the income", important, sometimes overriding, factors are the purpose of the expenditure and what the expenditure actually effects' (per Corbett JA in *Commissioner for Inland Revenue v Standard Bank of SA Ltd* 1985 (4) SA 485 (A) at 498F-G). And, in this connection the court has to assess the closeness of the connection between the expenditure and the income earning operations (*Nemojim* at 947G-H).

[11] In *Joffe & Co Ltd v Commissioner for Inland Revenue* 1946 AD 157, Watermeyer CJ held (at 163) that:

'All expenditure, therefore, necessarily attached to the performance of the operations which constitute the carrying on of the income-earning trade, would be deductible and also all expenditure which, though not attached to the trading operations of necessity, is yet *bona fide* incurred for the purpose of carrying them on, provided such payments are wholly and exclusively made for that purpose and are not expenditure of a capital nature.'

It was not disputed by the Commissioner that the business of the operating companies within the group could only have been conducted in the corporate form adopted by the group or that consolidation (and the preparation of consolidated financial statements for the group) and audit planning activities would have been necessary irrespective of whether Holdings lent money at interest or not. Nor was it in dispute that Holdings was

statutorily obliged<sup>1</sup> to appoint an auditor and to have its financial records audited. In those circumstances, the fees for a statutorily prescribed procedure such as an audit had to have been incurred by Holdings. Accordingly, it has to be accepted, that the audit fee expenditure was a part of Holdings' general overhead expenses enabling it to carry out all of its activities, irrespective of whether they involved the investment in subsidiaries, the lending of money interest-free to subsidiaries or the lending of money at interest. It follows that the Tax Court's conclusion that '[t]he auditing of financial records is clearly a function which is "necessarily attached" to the performance of [Holdings'] income-earning operations', cannot be faulted.

[12] Where - as here - expenditure is laid out for a dual or mixed purpose the courts in South Africa and in other countries, have, in principle, approved of an apportionment of such expenditure (*Secretary for Inland Revenue v Guardian Assurance Holdings (SA) Ltd* 1976 (4) SA 522 at 533E-H). Thus in *Nemojim*, Corbett JA stated:

'As pointed out in the *Rand Selections* case *supra* at 131E-G, the Income Tax Act makes no provision for apportionment. Nevertheless, apart from the *Rand Selections* case, it is a device which has previously been resorted to where expenditure in a globular sum has been incurred by a taxpayer for two purposes, one of which qualifies for deduction and one of which does not . . . It is a practical solution to what otherwise could be an intractable problem and in a situation where the only other answers, viz disallowance of the whole amount of expenditure or allowance of the whole thereof, would produce inequity or anomaly one way or the other. In making such an apportionment the Court considers what would be fair and reasonable in all the circumstances of the case.'

[13] Over time, the courts have applied various *formulae* to achieve a fair apportionment. In *Nemojim* (at 958D-F), Corbett JA applied the following formula to determine the extent of deductible expenses:

$$A = (B + C) \times \frac{D}{D + E}$$

where A = deductible expenses

B = general expenses relating to share-dealing

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<sup>1</sup> See for example s 269 read with ss 282, 300, 300A and 301 of the Companies Act 61 of 1973.

C = total cost of acquisition of shares in companies subjected to dividend stripping in tax year

D = total proceeds of the sale of such shares

E = total dividends received in respect of such shares.'

And, in *Commissioner for Inland Revenue v Rand Selections Corporation Ltd* 1956 (3) SA 124 (A), Centlivres CJ (who delivered the majority judgment) stated:

' . . . but, in my opinion, it was not legally competent for him to allow as a deduction from the "income" an amount which is arbitrary. In my opinion the obvious method of apportioning the expenditure is to adopt the following formula (X being the expenditure incurred, Y the amount of "income" and Z the amount of the "dividend"):

$$X \text{ multiplied by } \frac{Y}{Y \text{ plus } Z} \dots'$$

[14] Gildenhuis J held:

'[21] In all the above cases, the apportionment had an arithmetic basis, either through the use of a formula, or by allocating specific components of expenditure to deductible and non-deductible categories. Circumstances may occur, however, where it is not possible to devise a fair and reasonable formula, and also not possible to break down the expenditure into deductible and non-deductible components. In a case where the apportionment of expenditure between revenue and capital was at issue, *Tuck v Commissioner for Inland Revenue*, 1988 (3) SA 819 (A), Corbett CJ said at 834J-835B:

"The problem in this case is to establish an acceptable basis of apportionment. The appellant has all along suggested apportionment on a 50/50 basis; and this was Mr *Welsh's* suggestion to us. Having regard to the inherent nature of the receipt and its origin in the plan, it is not possible to find an arithmetical basis for appointment (*cf Commissioner for Inland Revenue v Rand Selections Corporation Ltd* 1956 (3) SA 124 (A) at 131; the *Nemojim* case *supra* at 958) but I do not think this should constitute an insuperable obstacle."

The learned Judge accordingly concluded:

'[26] Since neither the appellant nor the respondent suggested an acceptable basis of appointment, I am free to devise a basis which would in my view be fair. All in all, I am of the view that a 50/50 apportionment of the audit fees would be just and equitable. It will recognise not only the greater importance of the audit for the dividend earning operations, but also the longer time spent by the auditors on the interest earning operations. In the result, the appellant would be entitled to claim 50% of the audit fees as a deduction from "income" in respect of each of the four years of assessment.'

[15] Apportionment is essentially a question of fact depending upon the particular circumstances of each case (*Local Investment Co v Commissioner of Taxes* (SR) 22 SATC 4). As Beadle J put it in *Local Investment Co* (at II):

‘It does not seem possible to me to lay down any general rules as to how the apportionment should be made, other than saying that the apportionment must be *fair and reasonable, having regard to all the circumstances of the case*. For example, in one case an apportionment based on the proportion which the different types of income bear to the total income might be proper, as was done in the *Rand Selections Corporation’s* case, *supra*. In another case, however, such an apportionment might be grossly unfair; for example, in the case where the bulk of the expenditure was clearly devoted exclusively to operations intended to earn income, but which unfortunately in fact earned very little income, with the result that in the particular year of assessment the company earned very little “income”, but from operations which incurred little expense earned relatively large non-taxable amounts. In such a case to apportion the bulk of the expenses to the non-taxable amounts would be unfair. In another case a fair method of apportionment might be to take the proportion which the capital invested in the operations earning the non-taxable amount bears to the total capital invested, as was done in I.T.C. No 832 of 1956, *supra*.’

[16] Gildenhuys J usefully summarised the financial results of Holdings’ trading for the relevant tax years and the audit fees at issue that were disallowed by the Commissioner, as follows:

<b>Source of Revenue</b>	<b><u>2001</u></b>	<b><u>2002</u></b>	<b><u>2003</u></b>	<b><u>2004</u></b>
Dividends	R 170,000,000	R 350,000,000	R 1,125,273,121	R 717,000,00
Interest	R 21,765,415	R 22,223,856	R 21,636,279	R 6,000,000
TOTAL INCOME	R 191,765,415	R 372,223,856	R 1,146,909,400	R 723,000,000



<b>Tax Year</b>	<b>Revenue from dividends</b>	<b>Revenue from interest</b>
2001	89% of total revenue	11% of total revenue
2002	94% of total revenue	6% of total revenue
2003	98% of total revenue	2% of total revenue
2004	99% of total revenue	1% of total revenue

<b>Expenses</b>	<b><u>2001</u></b>	<b><u>2002</u></b>	<b><u>2003</u></b>	<b><u>2004</u></b>
Audit fees	R 365,505	R 647,770	R 427,871	R 233,786
Audit fees disallowed	R 323,884 (89%)	R 609,094 (94%)	R 419,799 (98%)	R 231,826 (99%)

[17] An audit is directed towards signing off an audit opinion. And, as Carel Gericke, the general manager: group tax within the MTN group, testified, an auditor has to undertake a wide range of general tasks which do not relate to specific income items. Holdings' contention was that if an apportionment were to be made, it should reflect the relative time spent or work done by the auditors on auditing Holdings' interest and dividend income. But as it was put in *ITC 1017* (1963) 25 SATC 337 (F) at 337 '[i]t is no good saying how little time and effort is devoted to the property company unless one can establish how much is devoted to the other ventures, for any such apportionment can only be on a comparative basis'.

[18] In assessing Holdings, the Commissioner apportioned the audit fees on the basis of the ratio between the taxable interest income and the exempt dividend income (which was the vast majority of its revenue). Although some interest-bearing loans were made, by far the greater part of the loans made by Holdings appear to have been interest free. The interest-earning operations of Holdings, which related primarily to supporting the employee incentive scheme, were relatively small in comparison to the activity of holding shares and earning dividends and the related activity of advancing the businesses of subsidiaries by large interest free loans. Indeed, on a proper conspectus

of all of the evidence, Holdings' value overwhelmingly lay in its principal business as a holding company of extremely valuable subsidiaries. Accordingly, the lending of moneys at interest in the context of its share incentive scheme was relatively modest. In any event it appears that the time spent specifically on dividend and interest entries between them may well have made up a relatively small component of the overall audit time. Moreover, the audit function involved the auditing of Holdings' affairs as a whole, the major part of which concerned the consolidation of the subsidiaries' results into Holdings' results. It follows that any apportionment must be heavily weighted in favour of the disallowance of the deduction given the predominant role played by Holdings' equity and dividend operations as opposed to its far more limited income-earning operations. It may as well be artificial to differentiate between each of the relevant tax years as the Commissioner did, inasmuch as the audit function would essentially have been the same for each of those years notwithstanding the proportion of Holdings' interest revenue as against its total revenue. It follows that whilst I agree with the Tax Court that in this case to invoke the arithmetical *formulae* laid down in cases such as *Rand Selections Corporation* and *Nemojim* may well lead to anomalous results, on the facts here present a 50/50 apportionment of the audit fees was far too generous to the taxpayer. In all the circumstances I consider that it would be fair and reasonable that only ten per cent of the audit fees claimed by Holdings for each of the tax years in question should be allowed.

[19] Turning to the KPMG fee: In its Rule 11 statement, Holdings alleged that the KPMG fee was incurred in respect of the 'implementation, adjustment, fine tuning and user operation of the [Hyperion] system'. The Tax Court took the view that Holdings should be held to that description. Ms Philisiwe Sibiya, the MTN group financial manager, who had joined the group after the Hyperion system had been acquired and obviously bore no personal knowledge about the matter, admitted as much during cross examination as the following excerpt demonstrates:

MR KOEKEMOER And that provides a breakdown. Do you have any personal knowledge of on what these fees were expended and what they achieved?

MISS SIBIYA Personal by was I there, no, sir, I wasn't there, but from what I know from Ron Stewart ... [intervention]

MR KOEKEMOER So from what other people told you?

MISS SIBIYA Yes.'

Mr Gericke, who like Ms Sibiya, also joined the group after the Hyperion system had been acquired, was no more illuminating. His evidence ran thus:

'MR KOEKEMOER Now this system, do I understand you correctly to imply that it is a software program?

MR GERICKE Yes

MR KOEKEMOER Which is loaded on whose servers?

MR GERICKE On whose server?

MR KOEKEMOER Well, I take it the software must run on a computer, a mainframe somewhere.

MR GERICKE Yes

MR KOEKEMOER Now, this mainframe, to whom does it belong?

MR GERICKE I'm not aware of that. I don't know. Honestly, I don't know.

. . .

MR KOEKEMOER So can we therefore safely assume that this operating system of yours, this Hyperion System, was installed in one of the other group companies' servers or mainframes?

MR GERICKE I don't know if you can assume that but that's probably where – the logical conclusion.

MR KOEKEMOER How much did you pay to acquire this system?

MR GERICKE I don't know that.

MR KOEKEMOER And who acquired this system, which company within the group?

MR GERICKE I don't know that either.

. . .

MR GERICKE No, I know what was performed as I said to M'Lord just now, my knowledge of what KPMG did with respect to the assistance is exactly that, that they helped with, you know, maximizing the operational capabilities of the system and showing us to use it to exploit its maximum capabilities.

GILDENHUYS J And who is us?

MR GERICKE Well, in this case the appellant.

GILDENHUYS J Did the appellant have staff that had to be shown?

MR GERICKE No, it didn't have staff, but it assisted the other employees, right, of the group who did render this particular – or who we were required to do the consolidation.

MR KOEKEMOER So you actually paid for an expense to train people other than the appellant's employees because it had none to operate the system.

MR GERICKE No, look it effectively – I don't think we paid anybody to train anybody or anything, right, it was there to assist, right, the appellant, well, in doing the required consolidations.

. . .

MR KOEKEMOER So you actually can't say what these Hyperion fees were expended upon.

MR GERICKE No, my understanding is that KPMG in those years assisted us with the operation of this particular system.

. . .

MR KOEKEMOER Who's the owner of this Hyperion System?

MR GERICKE Are you talking in the group?

MR KOEKEMOER Yes.

MR GERICKE I don't know.

MR KOEKEMOER So we don't even know whether the appellant is the owner?

MR GERICKE Well, it's not recorded as an asset in its financial statements.

MR KOEKEMOER So, for all we know, the appellant could have incurred [this] expenditure, the Hyperion expenditure, on behalf of another subsidiary in the group.

MR GERICKE I don't know. I mean, I'd have to speculate if I have to answer you.'

[20] There was, it must be added, no explanation from Holdings for its failure to call as witnesses persons at Holdings or KPMG with personal knowledge of the implementation and workings of the Hyperion system. Accordingly, given the inadequacy of the evidence adduced by Holdings, it was well-nigh impossible to determine whether the KPMG fee fell legitimately to be deducted by Holdings. It follows that the Commissioner cannot be faulted for having disallowed that fee in its entirety. In the result the contrary conclusion reached by the full court to that of the Tax Court that the deduction of the KPMG fee must be allowed in full, falls to be set aside.

[21] In the result:

(a) The appeal is upheld with costs, such costs to include those consequent upon the employment of two counsel.

(b) The order of the court below is set aside and in its stead is substituted the following order:

'(1) The appeal is dismissed with costs, including those of two counsel.

- (2) The cross appeal is upheld with costs, including those of two counsel.
- (3) The order of the Tax Court that “50% of the audit fees incurred for the 2001, 2002, 2003 and 2004 tax years is deductible from “income” (as defined) for those tax years” is amended by the deletion of “50” and the substitution therefor of “10”.’

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V PONNAN  
JUDGE OF APPEAL

## APPEARANCES:

For Appellant:

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