THE SUPREME COURT OF APPEAL
REPUBLIC OF SOUTH AFRICA

JUDGMENT

Reportable
Case Number : 60 / 06

In the matter between

BP SOUTHERN AFRICA (PTY) LTD **APPELLANT**

and

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICES **RESPONDENT**

Coram : **HOWIE P, BRAND, NUGENT, PONNAN et CACHALIA JJA**

Date of hearing : **22 FEBRUARY 2007**

Date of delivery : **13 MARCH 2007**

SUMMARY

Income Tax Act 58 of 1962 – section 11(a) – recurrent annual royalty payments – expenditure incurred in the production of income.

Neutral citation: This judgment may be referred to as :
***BPSA (Pty) Ltd v The Commissioner for SARS* [2007] SCA 7 (RSA)**

J U D G M E N T

PONNAN JA

[1] The appellant was incorporated on 9 May 1924 under the name Atlantic Refining Company of Africa Limited. On 2 July 1959, 35 years after commencing business, the appellant changed its name to BP Southern Africa (Pty) Ltd ('BPSA'). BPSA was until October 2001 a wholly owned subsidiary of BP Plc ('BP'), a UK-based company. Thereafter BP divested itself, pursuant to a Black Economic Empowerment deal, of a portion of its interest in BPSA. Since then BP has effectively held 75% of BPSA's shares.

[2] The petroleum market in South Africa is tightly regulated as to price and product. BPSA operates as a refiner, manufacturer, supplier and marketer of petroleum products. It purchases crude oil from abroad and manufactures or refines petroleum products in this country. It sells and distributes both nationally and elsewhere in Africa petroleum products that have either been refined or manufactured by it or purchased by it from one of its competitors in the industry. It likewise supplies other oil companies in South Africa with its products in terms of certain swap agreements.

[3] The BP trademarks ('the licensed marks') and the trade dress, colour schemes, designs and symbols ('the licensed marketing *indicia*') which BPSA commenced using during about 1959 are owned by BP worldwide. BPSA initially used the licensed marks and the licensed marketing indicia in terms of an informal oral arrangement with BP, and thereafter, in terms of a written agreement with BP free of any payment of royalties. During 1997 BPSA concluded a written trade mark licence agreement ('the agreement') with BP, in terms whereof it was granted

authorisation to use and display the licensed marks and licensed marketing *indicia* against payment of royalties.

[4] In terms of the agreement the royalty fee payable to BP was expressed as a rate per litre of product sold. It thus obviously varied from year to year. For the tax years 1997, 1998 and 1999 the royalty fee payments were respectively R40 190 000, R45 150 000 and R42 519 000.

[5] BPSA subsequently claimed those payments as deductions in terms of s 11(*a*) of the Income Tax Act 58 of 1962 ('the Act') in the determination of its taxable income. The respondent, the Commissioner of the South African Revenue Services ('SARS') disallowed those deductions. BPSA's objection to the disallowance was overruled and its subsequent appeal to the Cape Town Income Tax Special Court (Waglay J, sitting with assessors), was dismissed. Against that decision BPSA now appeals with leave of the Special Court.

[6] Section 11(*a*) provides

'**11 General deductions allowed in determination of taxable income** — For the purpose of determining the taxable income derived by any person from carrying on any trade, there shall be allowed as deductions from the income of such person so derived —

(*a*) expenditure and losses actually incurred in the production of the income, provided such expenditure and losses are not of a capital nature;'

(See *Commissioner, SARS v BP South Africa (Pty) Ltd* 2006 (5) SA 559 (SCA) para 6.)

[7] As has occurred many times in the past, this court is required yet again to determine whether expenditure incurred by a taxpayer is either capital or revenue expenditure. By now the distinction is hopefully clear enough conceptually (see *Rand Mines (Mining & Services) Ltd v Commissioner for Inland Revenue* [1997] 1 All SA 279 (A) at 285 and the cases there cited). The purpose of expenditure is important and often decisive in assessing whether it is of a capital or revenue nature. Expenditure incurred for purposes of acquiring a capital asset of the business is capital expenditure whereas expenditure which is part of the cost incidental to the performance of the income-producing operations as distinct from the equipment of the income-producing machinery is revenue in nature (*New State Areas Ltd v Commissioner for Inland Revenue* 1946 AD 610 at 627). A distinction is thus drawn between expenditure made to acquire an income-producing concern (in respect of which the outlay is usually non-recurrent) and money spent '. . . . in working the concern for the present production of profit' (*Commissioner for Inland Revenue v George Forest Timber Co Ltd* 1924 AD 516 at 526-527).

[8] The conclusion to be drawn from all of the cases seems to be that the true nature of each transaction must be examined in order to determine whether the expenditure in question is capital or revenue expenditure. (*New State Areas Ltd v Commissioner for Inland Revenue* 1946 AD 610 at 627.) In deciding that question each case must be decided on its own facts and circumstances. (*Commissioner for Inland Revenue v African Oxygen Ltd* 1963 (1) SA 681 (A) at 691 A-B.)

[9] In this case, the agreement commenced on 1 January 1997 and was initially to endure for a period of two years whereafter it would be renewed automatically for

succeeding periods of 12 months unless terminated by either party upon the giving of six months notice. For the purposes of this judgment, the further material terms of the agreement, in summary, were:

'(a) BPSA was granted a personal non-exclusive and non-assignable authorisation to use the licensed marks and the licensed marketing *indicia*;

(b) BP remained the sole rightful owner of the licensed marks and licensed marketing *indicia*, and all rights and goodwill attaching or arising out of the use by BPSA thereof accrued to the benefit of BP; and

(d) Upon termination of the 1997 agreement, BPSA would no longer be entitled to use the name BP Southern Africa or the licensed marks and the licensed marketing *indicia.*'

[10] The further facts giving rise to the dispute between the parties fall within a very small compass and were set out in a Statement of Agreed Facts which served before the court below. Nothing turns on those further facts. It is nonetheless perhaps important for the sake of completeness to record how royalties came to be paid by BPSA at the behest of its parent company BP for the use of the intellectual property in the first place. That, as also why the payment of royalties was first mooted after a protracted period of use free of payment, is explained thus in the stated case:

'(a) During the period from 1993 to 1996, BP sold a number of its divisions in various parts of the world and it became apparent during these sales that the licensed marks and the licensed marketing *indicia* carried a considerable commercial value.

(b) Consequently, during 1996 BP decided that users of the licensed marks and the licensed marketing *indicia* should be required to pay a royalty. Accordingly, it commissioned an independent company, Interbrand UK Limited ("Interbrand") to determine the value of its licensed marks and licensed marketing *indicia*. Interbrand was also commissioned to assess

> the fair market value of any royalty payments to be made to BP for usage of such licensed marks and licensed marketing *indicia* by all users thereof, including the Appellant.'

It was thus only after Interbrand had concluded its investigation that the agreement was concluded in accordance with recommendations made by it.

[11] It was contended for the respondent that the ostensibly brief initial duration of the agreement and the relatively short period required for termination after that initial period should not be accorded significant weight as the umbilical cord that ties BPSA to its UK parent is unlikely, after the initial term of the agreement or at any later time, to be severed. Accordingly, so it was argued, BPSA will effectively garner a benefit of far greater magnitude than, at first blush, the agreement confers upon it. That may well be so. But, to engage in such speculation would in my view be an act of grave folly. For it is to the agreement itself that one must look, which as ought to be apparent, provides the ready counter that the agreement might well not endure beyond its initial term of two years. There is nothing to suggest that the parties have concealed the true character of their agreement (see *Zandberg v Van Zyl* 1910 AD 302 at 309) or that they did not intend it to have effect according to its tenor; it must accordingly be interpreted by a court according to its tenor (see *Commissioner of Customs and Excise v Randles, Brothers & Hudson Ltd* 1941 AD 369 at 395-6). It bears noting that it was not contended by counsel for SARS that the transaction was simulated. Nor, given the agreement that had been reached to proceed by way of a stated case in the court below, could it be so contended.

[12] For the reasons that follow, the conclusion reached by the court below that the expenditure in issue is of a capital nature, does not, in my opinion have due regard to the essential features of the agreement and is therefore unsustainable.

[13] In order to determine whether expenditure has been incurred in the production of 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 Nemojim (Pty) Ltd* 1983 (4) SA 935 (A) at 947F-H.) The annual royalty payment, as the Statement of Agreed facts makes plain, was 'in consideration for the use of the licensed marks and the licensed marketing *indicia*'. Its purpose was to procure for BPSA the use – not ownership - of the intellectual property of another from its sole and rightful owner for the duration of the agreement. Thus the ownership of the intellectual property remained with BP throughout and, upon termination of the agreement, whether by virtue of non-renewal after the initial two-year period or the giving of six months notice by either party thereafter, BPSA would automatically cease to have the right to use the intellectual property in question.

[14] The anticipated and actual recurrent nature of the disputed payments is a strong indicator that they related to revenue rather than capital. The recurrent cost of procuring the use of something which belongs to another is usually recognised as being of a revenue nature. The most obvious example is the recurrent rent paid by a taxpayer for the use of premises from which he/she trades. As Centlivres CJ stated: '[r]ent is an expenditure incurred in the production of income and is of a non-capital nature and is therefore deductible … for the purpose of determining taxable income' (*Turnbull v Commissioner for Inland Revenue* 1953 (2) SA 573 (A) at 579 A-B.) The annual royalty fee in the present case is to all intents and purposes indistinguishable from recurrent rent paid for the use of another's property.

[15] A cardinal feature of the present case is that the expenditure in issue neither created nor preserved any capital asset in the hands of the taxpayer. Whilst not in itself conclusive that is indeed a consideration of considerable importance. (*Warner Lambert SA (Pty) Ltd v Commissioner, SARS* 2003 (5) SA 344 (SCA) at para 17.) Where no new asset for the enduring benefit of the taxpayer (enduring in the way that fixed capital endures (*New State Areas Ltd* at 625A)) has been created, any questioned expenditure naturally tends to assume more of a revenue character (*Warner Lambert SA (Pty) Ltd* par 17).

[16] Having regard to all of the circumstances, the expenditure in issue was, in my judgment, so closely linked with the appellant's income-earning operations during the tax years in question, as to constitute revenue expenditure in respect of each of those tax years. It follows that those sums were deductible under the provisions of section 11(*a*) of the Act. This conclusion renders it unnecessary to consider the further submissions advanced on behalf of BPSA which called in aid section 11(f) of the Act.

[17] In the result:

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

(2) The judgment of the Special Court is altered to read:

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

(b) For the tax years 1997, 1998 and 1999, respectively, the sums of R40 190 000, R45 150 000 and R42 519 000 are declared to be deductible under s 11 (*a*) of the Act;

(c) It is directed that the assessments be altered accordingly.

V M PONNAN
JUDGE OF APPEAL

CONCUR:

HOWIE P
BRAND JA
NUGENT JA
CACHALIA JA