

SOUTH AFRICA / JUDGMENT

ABC (Pty) Limited v Commissioner for the South African Revenue Services (13356) [2013] ZATC 5 (2 December 2013)

[2013] ZATC 5

COURT

Tax Court

BEFORE

M Victor, N Mazibuko, I Nkama

CASE / FILE NUMBER

13356

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REPUBLIC
OF SOUTH AFRICA
IN
THE SPECIAL TAX COURT
HELD
AT MEGAWATT PARK JOHANNESBURG
CASE
NO: 13356

REPORTABLE:	YES OF INTEREST TO OTHER JUDGES: YES REVISED.
DATE:	NJ fap/3 In the matter
between:	ABC (PTY) LIMITED Appellant and THE COMMISSIONER FOR SOUTH AFRICAN REVENUE SERVICES Respondent

JUDGMENT

VICTOR, J:

- [1] The issue for determination in this appeal is the interpretation of the judgment handed down by the Supreme Court of Appeal and whether it meant that the respondent (the Commissioner) could disallow a deduction of R64,346,528 described as 'further costs' claimed by the Appellant (ABC). The Commissioner contends that the category per se was not pursued beyond the trading stock issue and thus not preserved as a separate issue before the SCA. ABC contends that the issue was successfully characterised as an alternative to the trading stock issue and therefore a justiciable issue before the SCA.
- [2] A brief background history is relevant to the present dispute. ABC concluded a private/public partnership with the State Department of Correctional Services to build a prison on state owned land in Makhado (then known as Louis Trichardt) in the Limpopo Province. Its brief was to design, construct, operate and maintain a maximum security prison for 25 years. The Commissioner disallowed the expenditure incurred by ABC and the dispute came before the presiding judge in the Tax Court a quo. He had to determine whether the expenditure relating to the construction and various financial expenditures for this project was of a capital or of a revenue nature. The tax court a quo found that all the expenditure of some R464 376 824 was of a revenue nature. Consequently all the expenditure was deductible in terms of section 22(2A) of the Income Tax act 58 of 1962 (Act). The whole amount of some R464 376 824 was treated as trading stock and was deductible.
- [3] The Commissioner appealed the decision of the Tax Court a quo to the Supreme Court of Appeal and its judgment is 2012 (1) SA 522 (SCA)[4] . In paragraph [1] of the judgment Plaskett AJA raised three issues for determination and for reasons relevant to the interpretation of the judgment these are: 'the validity of ABC's objection to the assessment for the 2002 year of assessment, the deductibility of the cost of constructing and equipping the prison, and the deductibility of interest and other costs.'
- [4] The first of the three issues was essentially a prescription point and ABC succeeded on that point. The second of the three issues was the deductibility of the expenditure of the entire project as being of a revenue nature and the appeal against the tax court a quo's decision was upheld and the Commissioner succeeded on that point. ABC succeeded on the third issue being the deductibility of interest and other costs.
- [5] Although it is the third issue that requires interpretation it is necessary to touch briefly on the second issue. In this regard ABC had subcontracted the construction and equipping of the prison to an independent subcontractor M. The SCA considered the relationship between the appellant and its subcontractor M. Plaskett AJA found that expenditure by ABC did not fall within the parameters of section 22(2A) read with S11(a) of the Act as it never carried on any construction or brought building materials onto the site or other trade in the course of which improvements were effected by it to the land which was state owned. It was

M the builder who would have been entitled to a deduction. The SCA disallowed the deduction of the expenditure of R228 821 436 incurred in respect of the construction of the prison and R95 558 256 in respect of provisioning it. The total amount disallowed was R324 379 692. Since the total amount in issue was R464 376 824, this meant that the SCA was left to deal with the balance of the amount claimed which comprised deductibility of interest and other costs.

- [6] In order to bid for the tender and raise loans, ABC had to finance the construction of the prison and it incurred a number of fees to various parties. It also incurred interest on its loans and claimed in the alternative to be entitled to a deduction in respect of the various fees and the interest in terms of s 11(bA) of the Act. S11(bA) provides:

" For the purposes 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 persons so derived ... (bA) any interest (including related finance charges) which is not otherwise allowable at a deduction under this Act, which has been actually incurred by the taxpayer on any loan, advance or credit utilised by him for the acquisition, installation, erection or construction of any machinery, plant, building, or any improvements to a building ... to be used by him for the purposes of his trade, and which has been so incurred in respect of a period prior to such machinery, plant, building, improvements . . . being brought into use for the purposes of the taxpayer's trade, such deduction to be allowed in the year of assessment during which such machinery, plant, building, improvements ... is or are brought into use for the said purposes."

- [7] In paragraph [49] of the judgment the learned Justice stated:

' The interest that ABC has incurred is, in my view, deductible in terms of s 11(bA): it has been 'actually incurred' by ABC on its loans from A Bank and F Bank to pay M for the construction of the prison. I am also of the view that the various fees are deductible in terms of s 11(bA): because of their close connection to the obtaining of the loans and the furtherance of ABC's project, they qualify as 'related finance charges' for purposes of the section.'

- [8] In order to make sure the expenses had in fact been incurred in the relevant tax year it was on that basis that the was matter was referred back to the Commissioner in terms of *Caltex Oil SA Limited v Secretary for Inland Revenue* 1975 (1) SA 365 (A) at 3748-F. This is referred to as the timing issue.
- [9] The SCA order relevant to this matter being Prayer 3 reads as follows: 'The order of the court below is set aside and replaced with the following: "The assessment is referred back to the Commissioner for him to determine the amount that is deductible from the appellants income in terms of s11(bA) of the Income Tax act 58 of 1962".

- [10] Upon being referred back, the Commissioner disallowed the guarantee fee of R15 561 131 paid to X; the guarantee fee of R77 333 paid to C Bank; the introduction fee of R47 484 608 paid to Y; R6 209 274 paid to C Bank; margin fee R2 545 077 in respect of negotiations for loans with A Bank and F Bank; the commitment fee paid to A Bank and F Bank; the initial fee paid to A Bank and F Bank; the administration fee paid to F Bank; the legal fees paid to attorneys D and all other fees and the 'further costs' .
- [11] Just prior to the trial in this Tax Court, the Commissioner conceded all the above save for the 'further costs' category of R64,346, 528. The only amount and category in issue for interpretation in this court is whether the "further costs" of R64, 346, 528 ought to be deductible in accordance with the judgment of the SCA. This category of 'further costs' comprises for example bid expenses, developer fees, legal fees, insurance, start up costs, specialist advocate costs, lenders technical advisors costs. ABC submitted that these items have the character of related finance charges e.g. lenders technical advisors, legal fees (cost of drafting loan agreements) and costs of insurance required by the lenders and also necessary to bid for the project and

its furtherance.

- [12] It is ABC's contention that once the matter was referred back, the Commissioner was not at large to disallow the deduction of R64, 346,528 as the Commissioner's role was limited to the timing issue of whether the expenses had been incurred in the relevant year as per the principle in *Caltex supra*.

Was the further costs category raised before the SCA?

- [13] The question raised is whether the issue of 'further costs' was properly raised as a justiciable issue in the SCA. ABC contends that this is a factual issue which can properly be determined by the members of the Tax Court and I. The members of the court comprise an accountant and a person highly experienced in the business world. We as the court are in agreement that this is a factual issue which the tax court can decide upon. It is permissible for the members of the court to consider the procedural documents such as the objection to the assessment, the disallowance of the objection, the notice of appeal, the statement of the grounds of assessment and the grounds of appeal. This does not encroach upon interpreting the

judgment.

- [14] The Commissioner contends the 'further costs' of R64 346 528 is a new issue and not raised during the various appropriate stages in terms of s 81 of the Act and in the Tax Court rules 4, 5, 6, 10 and 12 stages. In addition the Commissioner contends that it was not raised as a separate issue before the SCA. The Commissioner contends that at all times the 'further costs' category was a trading stock issue.

[15] In paragraph 5.7.5 of the objection of 19 September 2007 ABC raises the issue of further costs but under the legal submission that it falls within trading stock provision. In response to this ietter and in May 2008 the Commissioner responded and disallowed the objection. In particular in this document reference is made to the fact that 'further costs' as a category is not deductible under 11(a). In its letter of 11 June 2008 ABC attached a formal notice of appeal and all the costs including the 'further costs', featured as separate category within the table of costs.

[16] The statement of the grounds of appeal in paragraph 32 deal with costs as a sub category of all the costs to be dealt with in terms of s 22(3A). It does not stop there. In paragraph 35 of the statement of grounds of appeal ABC states the following:

'Alternatively, and only to the extent that the provlsions of section s22(2A) and (3A) do not apply to any expenditure incurred by the appellant, such expenditure is deductible in terms of s11(a) and or section 11(bA) and/or section 24J of the Act'. (emphasis by ABC for purpose of argument).

There is also reference in the heads of argument to this category in general terms and in fact the Commissioner lists this category as a disputed costs issue.

[17] The grounds of appeal raises the 'guarantee fee, the introduction fee and finance charges' as a s11(bA) issue and also raises other issues re costs such as the costs of outside consultants, legal fees, administration fees and related finance charges under different sections of the Act. The disallowance of objection document deals with the 'guarantee fee, the introduction fee and finance charges' and the costs are referred to under different sections of the Act. In the formal notice of appeal the 'guarantee fee, the introduction fee and finance charges' are referred to as an s11(bA) issue but the further costs issues is now referred to as a s11(a) issue and a range of other costs are referred to. The Rule 10 statement of grounds of assessment deals with general issues of deductibility and there is an introduction of a category referred to as a raising fee. There is no express reference to 'further costs category' but costs are referred to generally. A very clear picture emerges in the statement of grounds of appeal where ABC placed specific reliance on s11(bA) in the alternative should the s22(2A) and (3A) interpretation fail.

[18] In the light of the detailed history set out above we are of the view that it was a category of expenditure in the alternative before the SCA. We accept the submission by ABC that it was not abandoned. We also find that the nomenclature of the category 'further costs' for this range of expenditure was not ideal as it covered various categories of costs such as legal fees and developer fees and start up costs which could so easily have been dealt with when the other fees were categorised and dealt with. In the absence of a line by line scrutiny by the SCA, I accept that the categorisation of 'further costs' is not a rigid category. It is nomenclature used as a tool of convenience by auditors. The label of this category does not place a rigid limitation on the legal interpretation of tax principles when considering the various items within it.

[19] Having established factually that it was an issue before the SCA it becomes necessary to interpret the judgment to determine whether it was fairly placed as a justiciable issue before the SCA. It therefore becomes necessary to interpret the

judgment.

[20] The interpretation of a judgment can only be done by a judge and not the full Tax court. Harms DP in KPMG Chartered Accountants (SA) v Securefin Ltd and Another 2009

(4) SA 399 (SCA) '... interpretation is a matter of law and not of fact and, accordingly, interpretation is a matter for the court and not for witnesses (or, as said in common-law jurisprudence, it is not a jury question: Hodge M Malek (ed) Phipson on Evidence (16 ed 2005) paras 33- 64).'

Interpretation of the Judgment.

[21] The principles for interpreting orders and judgments of courts have been traversed in several judgments. See Firestone South Africa (Pty) Ltd v Genlicuro AG 1977 (4) SA 298 (A); Administrator, Cape, and another v Ntshwaqela and others 1990 (1) SA 705 (A); Finishing Touch 163 (Pty) Ltd v BHP Billiton Energy Coal South Africa Ltd and Others 2013 (2) SA 204 (SCA) Natal Joint Municipal Pension Fund v Endumeni Municipality 2012 (4) SA 593 (SCA). In Firestone Trollip JA stated that the judgement must be construed from its language as a whole and only if there is uncertainty should extrinsic evidence be investigated. In Finishing Touch supra it was held that one must examine the purpose of the judgment or order and consider the context.

[22] In Natal Joint Municipal Pension Fund supra Wallis JA para [18] stated in relation to interpreting documents that

'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 that leads to insensible or unbusinesslike results or undermines the apparent purpose of the document. Judges must be alert to, and guard against, the temptation to substitute what they regard as reasonable, sensible or businesslike for the words actually used.'

[23] It is also appropriate to refer to the latitude given and the nature of the extrinsic evidence which can be relied upon when interpreting judgements. In Frankel Max Pollak Vinderine Inc v Mene/1 Jack Hyman Rosenberg & Co Inc and Others [1996] ZASCA 21; 1996

- (3) SA 355 (A) Corbett CJ at 363C stated: 'On general principles and as a matter of logic, however, it seems to me that such extrinsic circumstances include the issues which were submitted to the arbitrator for adjudication and the evidence placed before him, insofar as such evidence throws light upon what the canvassed issues were'. This would even allow for a transcript of the argument before the SCA

The Judgment and Order

- [24] In applying the above principle both parties contended for different interpretations of the judgment and order. Both parties contended that primarily it was not necessary to go beyond the judgment and order but both parties by way of background referred to the appeal procedural documents and the heads of argument. I also have to consider the nature of the material before the SCA. It would seem that all the above mentioned procedural documentation, the heads of argument and the contract were before the SCA. I do not have a full list or indeed the transcript of the argument. The parties are represented by experienced counsel so I must assume that a transcript of the argument before the SCA would not contain helpful material otherwise it would have been made available to me on the basis of the admission of extrinsic evidence. The parties presented excerpts from various paragraphs of the SCA judgment and superimposed them on a lattice of legal structure in the judgment to support their interpretation.
- [25] ABC contended that one should not apply a superficial nuance or impression of the words and categories used by the SCA. One ought to consider the rationales and the reasoning of the SCA otherwise one arrives at too slender a basis for arriving at a conclusion that the SCA did not deal with an amount as large as R64 346
528. ABC contends that the SCA did not undertake line item scrutiny but dealt with principles, hence the absence of the express words 'further costs'.
- [26] ABC contended that there were limitations to be read into the order. The Commissioner only had to attend to deductions under s11(bA) based on the timing issue and did not have the discretion to decide whether there should be a deduction of any item. The Commissioner also had to allocate to specific years those portions of the deductions that were actually incurred in the relevant years. Only the year 2002 is relevant. ABC therefore relied on the order as it was worded and submitted that it was to be interpreted as it stood. In the light of the disputed interpretation of the order it was clearly necessary to look at the judgment itself. This was done in great detail by both parties.
- [27] If the order is unclear then the first extrinsic source would be the judgment itself. ABC referred to the following words and phrases in the judgment to support their case that the 'further costs' were considered in the overall picture before the SCA. The emphasis is in bold. Para [1] 'and the deductibility of interest and other costs'; para

- [18] 'The total amount involved, made up of the construction and equipping costs and the financial costs, was R464 376 824; above para [47] the heading 'The third issue: the deductibility of the various fees' ; In order to bid for the tender and to raise the loans that it required to finance the construction of the prison, ABC incurred a number of fees payable to various parties. ' it claims to be entitled to a deduction in respect of the various fees and the interest in terms of s 11(bA) of the Act; para [49] 'am also of the view that the various fees are deductible in terms of s 11(bA): because of their close connection to the obtaining of the loans; para [49] the furtherance of ABC's project.
- [28] Obviously these phrases must be read within the context of where they are found in the judgment. The words 'other costs', 'financial costs', 'in order to bid for the tender', 'raise the loans', various fees' and 'furtherance of the ABC' project' does extend the deductibility principle beyond a very limited interpretation. The SCA dealt with related finance charges in a short conclusion in para [49] without doing a line item scrutiny. In my view a broad approach was adopted by the SCA in interpreting the deductibility principle. The touchstone used by the SCA to extend the principle was to incorporate all the costs as a related finance charge that was closely connected with the furtherance of the project.
- [29] Both parties submitted that the structure of the judgment provides meaning to the interpretation of the judgment. ABC submitted that the important structural features includes the fact that the SCA did not remit the matter back to the Tax Court a quo with directions as to a reconsideration on what must be considered as deductible. The Commissioner argued that it was unnecessary to do so as the deductibility items were defined by the SCA in paras [14]-[17] of the judgment.
- [30] The SCA did not distinguish fees in the narrow sense in its formulation of the issues in para [1] and this in my view is an important consideration. The further structural issue relied upon by ABC is that of the manner in which the SCA dismissed or upheld each issue. e.g. (first issue 'there is no merit in the point'; on the second issue 'the Commissioner's appeal must succeed to this extent' and the third issue 'Consequently ABC succeeds on this aspect'. ABC emphasised that the SCA did not state that ABC succeeded partially on the third issue, bearing in mind that the entire alternative issue was before it in terms of s11(bA)). ABC contends that the structural, contextual-linguistic and rationales factors outweigh the linguistic factors contended for by the Commissioner.
- [31] The Commissioner contends that a logical, objective and sensible approach to the judgment is necessary. The Commissioner contends that there is a synchronicity in the context, structure and words of the judgment. He also contends that the words of the judgment must be assessed in the context of the material known to the judges of Appeal.

- [32] The Commissioner emphasised that the rationale to arrive at the s11(bA) conclusion is to be assessed in the light of what is actually said in paras [14]-[17]. As can be seen from the judgment the following items were referred to in those paragraphs: guarantee fee, introduction fee, bid guarantee fee, financial advisory fee, administration fees, commitment fee, initial fee, legal fees and interest on loan facilities.
- [33] The Commissioner contends that these are the various fees referred to in the structure of the judgment and are limited to those in paras [14] to [17] and therefore could not encompass the 'further costs' category. The category of fees allowed by the SCA goes way beyond what was described by the Commissioner as the only s11(bA) category before the SCA e.g the 'guarantee fee, the introduction fee and finance charges'. One of the bases to support this was reliance upon the descriptions in the statement of grounds of assessment and in line with the alternative ground referred to in the statement of grounds of appeal. Both parties in the procedural path to the Tax Court referred to various legal bases for their contentions. Neither party can be prejudiced if an incorrect legal submission is made in the early stages of the path to the Tax Court and indeed even further.
- [34] The Commissioner emphasises that para [18] of the judgement commences with the words 'Apart from the various fees that were payable by ABC,' In para [47] 'the individual fees, their purpose and the parties to whom they were paid have been set out above. ABC also incurred interest on its loans.' In para [49] 'I am also of the view that the various fees are deductible'. The argument placed emphasis on the manner and place in which the words 'various fees' appeared in the text of the judgment and could only refer to those fees listed in para [14] to [17]. The Commissioner contends that both in the disallowance of the ABC objection document and ABC' grounds of appeal the alternative ground of objection focused on 'guarantee fees, introduction fee and other finance charges'.
- [35] This argument must fail in the light of the broader approach by the SCA to the various categories of costs. If the only s11(bA) category was the guarantee fees, introduction fee and other finance charges then the allowable deductions would have been limited to those categories only. Instead the SCA went much wider in allowing raising fees (margin fee, financial advisory fee, commitment fee, bid guarantee fee) to be deductible because of 'the close connection to the obtaining of loans and the furtherance of the ABC' project'. The SCA characterised the various fees as a related finance charge for the purpose of s11(bA).
- [36] In the judgment in paras [14] to [17] there is reference to administration fees and initial fees and these are not referred to specifically in the sections quoted by the Commissioner in the disallowance of ABC' objection document as well as grounds of appeal document.
- [37] To sum up the Commissioner only emphasised the guarantee fees, introduction fee and other finance charges as an s11(bA) issue. Ultimately the SCA provided for a wider range of fees as being deductible in terms of s11(bA).

- [38] It is correct that no where in the judgment is reference expressly made to the category of 'further costs'. The judgment however goes much wider than guarantee fees, introduction fee and other finance charges. It refers to a range of other fees which were not highlighted in the disallowance document and the grounds of appeal document. The SCA with respect must have had in mind a broader approach to the proper application of s11(bA).
- [39] From the documents and submission made in this court it seems to me that the 'further costs' category was not pursued with the usual adversarial vigour and thus resulted in the SCA not dealing with it as a separate category but at the same time the issue was not abandoned.
- [40] The concession on the eve of the hearing in this court on a wide range of fee categories also goes way beyond the guarantee fee, introduction fee and deductible finance charges on which the Commissioner relies for his interpretation. This is relevant in my view. Implicit in the judgment of the SCA is the application of the principle to a wide range of costs and this means that the 'further costs' category falls to be interpreted within the ambit of the s11(bA) albeit that it was obliquely canvassed in the SCA.
- [41] Some of the items in the 'further costs' category are the same as those which the SCA ruled deductible. The interpretation and application of the principle cannot be limited because of an absence of an express reference to a category known as 'further costs' in the SCA judgment. Principles emanating from judgments are meant to be applied to different facts otherwise the law would be a static process. A sensible objective observer looking at the judgment in its entire context would note the import of the principles of allowing the deductions of a wide variety of fees and the like. The category 'further costs' is but a descriptive outline or a convenient label perhaps for accountants. On the whole the items listed in 'further costs' are a 'close connection' to the furtherance of the project.
- [42] Once that is so, in the absence of an express reference to disallowing 'further costs', I conclude that the judgement must be interpreted to include further costs. I direct that the Commissioner must deduct the category of costs labelled as 'further costs'.
- [43] In determining the question of costs of the matter in this Tax Court, the Commissioner's opposition was not unreasonable and therefore no costs order is made.

The order that I would make is the following:

1.

The 'further costs' category shall be deducted by the Commissioner.

2.

No costs order is made

M VICTOR

PRESIDENT OF THE SPECIAL TAX COURT

I concur per email

ACCOUNTANT MEMBER: Mr N Mazibuko

COMMERCIAL MEMBER: Mr I Nkama

DATE OF HEARING: 25 November 2013

DATE OF JUDGMENT: 2 December 2013.

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